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**LATIN AMERICAN SPECIAL ECONOMIC ZONES AND
THEIR IMPACTS ON REGIONAL SECURITY**

by

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June 2011

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**LATIN AMERICAN SPECIAL ECONOMIC ZONES AND THEIR IMPACTS
ON REGIONAL SECURITY**

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ABSTRACT

Latin America is often considered the United States' strategic backyard. However, with the advent of globalization and technology, this backyard is no longer strictly "American." As the region becomes more accessible and readily influenced by external actors and the United States' security concerns focus elsewhere, a growing opportunity is present in the Western Hemisphere for organized criminal networks and terror financing to take hold. Although globalization provides Latin American nations with ties to the world economy, it comes at a price for regional security. One of the most vulnerable products of a globalized Latin America is the Special Economic Zones in the region.

Special Economic Zones (SEZs) throughout Latin America represent the delicate seesaw game that globalization and security play. Although SEZs attract foreign direct investment, fuel jobs, and grow linkages in local economies, they are also extremely vulnerable to crime and corruption. The entrenched permissive environment for criminal activity and links to transnational terrorism is a serious issue for regional and global security.

This paper will examine the vulnerabilities of SEZs in Latin America through a comparative case study approach of the Colon Free Zone and the Triple State Border Area (Zona Franca de Ciudad del Este).

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LIST OF ACRONYMS AND ABBREVIATIONS

AMLU	Anti-Money Laundering Unit
AOR	Area of Responsibility
ASEANPOL	Association of South East Asian Countries Police
ATA	Anti-Terrorism Assistance
BPME	Black Market Peso Exchange
CARICOM	Caribbean Common Market
CBP	Customs and Border Patrol
CFATF	Caribbean Financial Action Task Force
CFZ	Colon Free Zone
CIA	Central Intelligence Agency
CICAD	Inter-American Drug Abuse Control Commission
CSI	Container Security Initiative
CTF	Counter Terrorism Financing
CV	Commando Vermelho—Rio de Janeiro-Based Organized Crime
DEA	Drug Enforcement Administration
DHS	Department of Homeland Security
DTT	Double Taxation Treaties
ECLAC	Economic Commission for Latin America and the Caribbean
EPP	Paraguayan's Peoples Army
EPZ	Economic Processing Zone
EUROPOL	European Union Police
EXBS	Export Control and related Border Security
FARC	Colombian Revolutionary Armed Forces

FATF	Financial Action Task Force
FATF	Financial Action Task Force
FBI	Federal Bureau of Investigations
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
FIU	Financial Information Unit
FMF	Foreign Military Financing
FMF	Foreign Military Financing
FPMR	Frente Patriótico Manuel Rodríguez—Chilean Communist Group
FTZ	Free Trade Zone
GAFISUD	Financial Action Task Force of South America
GDP	Gross Domestic Product
GOP	Government of Panama or Government of Paraguay
HNWI	High Net Worth Individuals
ICE	Immigration Customs Enforcement
ICJ	International Court of Justice
ILO	International Labor Organization
IMF	International Monetary Fund
INCSR	International Narcotics Control Strategy Report
INTERPOL	International Police
ISI	Import Substitution Industrialization
LDC	Less Developed Country
MERCOSUR	Market of the South—South American Trade Block
MLAT	Mutual Legal Assistance Treaty
OAS	Organization of American States

ODC	Office for Defense Cooperation
OECD	Organization for Economic Cooperation and Development
OFAC	Office of Foreign Assets Control
PCC	Primer Commando Capital—Sao Paulo Based Brazilian Organized Crime
PNP	Panama National Police
PTJ	Technical Judicial Police
SAN	Panamanian National Air Service
SDGT	Specially Designated Global Terrorist
SENAFRONT	Panamanian National Border Service
SENAN	Panamanian National Aero-Naval Service
SENIS	National Intelligence and Security Service
SEZ	Special Economic Zone
SICA	Central American Integration System
SMN	Panamanian National Maritime Service
STR	Suspicious Transaction Report
TBA	Tri State Border Area between Brazil, Argentina and Paraguay
TBA	Triple State Border Area
TIEA	Tax Information Exchange Agreement
TIP	Trafficking in Persons
TSC	Theatre Security Cooperation
TTU	Trade Transparency Unit
UN	United Nations
USAID	United States Agency for International Development
UDSAO	United States Defense Attaché Office

WEPZA	World Economic Processing Zone Association
WMD	Weapon of Mass Destruction
ZFI	Ciudad del Este Free Trade Zone
ZFPI	Puerto Iguazu Free Trade Zone
ZL	Zona Libre—Free Zone

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I. INTRODUCTION

A. DISCUSSION

Latin America is often considered the United States' strategic backyard. However, with the advent of globalization and technology, this backyard is no longer strictly "American." As the region becomes more accessible and readily influenced by external actors and the United States' security concerns focus elsewhere, a growing opportunity is present in the Western Hemisphere for organized criminal networks and terror financing to take hold. Although globalization provides Latin American nations with ties to the world economy, it comes at a price for regional security. One of the most vulnerable products of a globalized Latin America is the Special Economic Zones in the region.

Special Economic Zones (SEZs, also commonly known as Free Trade Zones or Economic Processing Zones) throughout Latin America represent the delicate seesaw game that globalization and security play in the region. Although SEZs attract foreign direct investment, fuel jobs, and grow linkages in local economies, they are also vulnerable to crime and corruption because they typically feature reduced regulation and oversight. This is especially true in many areas of Latin America that lack institutional controls and infrastructure.

Moreover, transnational criminal organizations in SEZs have been linked with terrorist groups around the globe. The bombings in Buenos Aires of the Israeli Embassy in 1992, and the Jewish Community Center in 1994, are reportedly linked to terrorist cells coming from the SEZ located in the Tri-State Border Area (TBA) between Argentina, Brazil and Paraguay.¹ Since the 2001 attack on the World Trade center in New York, several individuals have been arrested in the TBA for financing terrorist groups like Hamas and Hezbollah, including Assad Ahmad Barakat in 2002² and Moussa Ali

¹ Rex A. Hudson, *Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America*, Washington, D.C.: Federal Research Division, Library of Congress, 2003, accessed March 12, 2010, http://edocs.nps.edu/govpubs/LOC/FRD/Jul03_TerrOrgCrime.pdf.

² Hudson, *Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America*, 29.

Hamdan in June 2010.³ With an entrenched permissive environment for criminal activity and links to transnational terrorism, curbing the nexus of organized crime and terror financing in SEZs is a serious issue for regional and global security. How serious is the threat found in Latin American Special Economic Zones to regional and global security? Who are the actors engaged in these SEZs? What are the factors that make some SEZs more vulnerable than others? Which SEZs are problematic and which are not? What policy outcomes work and what needs further attention?

The TBA is only one of many SEZs to spring up in the region over the past three decades. SEZs are considered popular economic solutions that provide immediate comparative advantages for states with limited industrial bases. As a result, many political and economic actors invested in SEZs see very little incentive to maximize security and would rather have liberal oversight and loose regulations in order to facilitate trade and commerce. SEZs have proliferated throughout the globe, particularly in developing regions like Latin America. Latin America is now the region with the third most SEZ's in the world, employing over 5.8 million people, second most after Asia. The employment impact of SEZs is difficult to fully comprehend since the economic incentives that attract legitimate business, nonetheless, also attract illicit ones. Additionally, there are also large shadow economies and black markets associated with many of these SEZs.

³ Marta Ecurra, "Moussa Ali Hamdan, as suspected Hezbollah financier, arrested in Paraguay," accessed June 16, 2010, <http://www.inforsurhoy.com>.

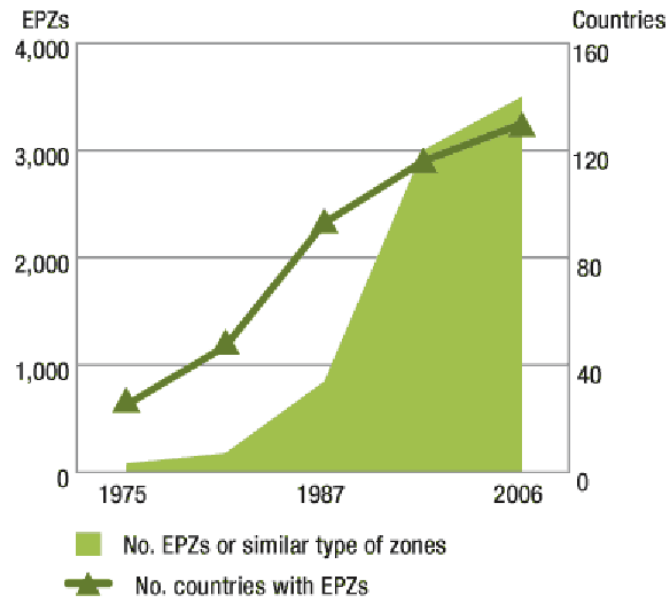


Figure 1. SEZ Proliferation⁴

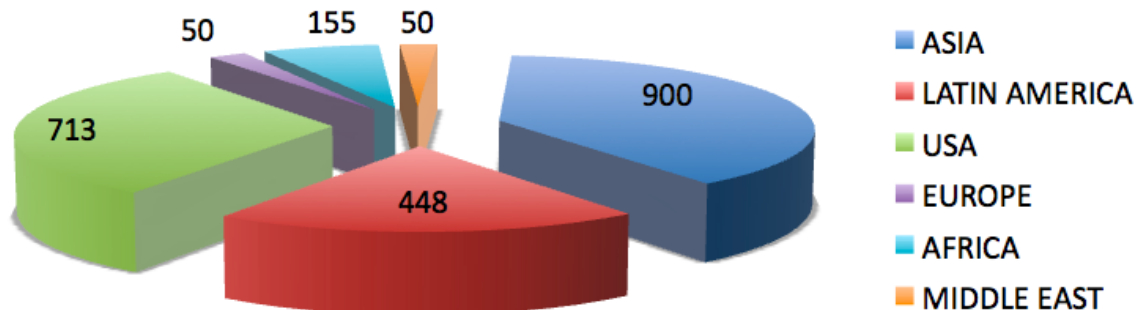


Figure 2. SEZs by Region⁵

Another interesting dynamic of SEZs is it provides a salient environment where transnational organized criminal networks have in some instances shared alliances with terrorists. Although native Latin American insurgent groups like the FARC in Colombia

⁴ Jeanne-Pierre Singa Boyenge, *ILO Database on Export Processing Zones*, (Geneva: International Labour Office, 2007), 1.

⁵ Data from ILO.

and Sendero Luminoso in Peru are seemingly in retreat, transnational Islamic terrorists and organized crime syndicates like the Mexican drug cartels have stepped into the permissive environments found in SEZs to finance their causes. Additionally, U.S. and international attention to particular SEZs does not stop illicit actors from moving their businesses to other SEZs where there is less scrutiny. SEZs like the ones found in Isla Margarita, Venezuela or Iquique, Chile have perhaps become more attractive as safe havens simply because there is less attention focused on them. The very nature of SEZs as centers of trade and commerce with shared linkages facilitates the trade of goods and people between them. Thus, illicit activities like smuggling, trafficking in persons, proliferation of WMD or dirty bombs, drug trade, and terror financing are all bi-products found in the permissive environments of SEZs in Latin America. A regional approach to the SEZ security issues is needed.

B. ASSESSMENTS OF SEZS

Most arguments in favor of SEZs focus on the positive developmental effects that these zones have for a host country. In a detailed study of SEZs and EPZs in South East Asia, Kanesku Jayanthakumaran writes, “The results show support for the hypothesis that EPZs make a positive economic impact for the citizens of a host country.”⁶ He summarizes that zones have in all cases played an important role as catalysts for local employment, entrepreneurship expansion and technology transfer. He makes the case that the preferential treatment within SEZs attracts foreign capital inflow, and thereby pools together local labor and resources to establish backwards linkages in the host nation’s economy. Kanesku’s argument, however, also heavily emphasizes the importance of the proximity of an SEZ to the industrial core of a host nation’s economy (both in the geographic and economic context), to sufficiently produce backwards linkages.

⁶ Kanesku Jyanthakumaran, “Benefit-Cost of Export Processing Zones: A Survey of the Literature,” *Development Policy Review*, 21 (1), 2003: 63.

Economists that share positive views of SEZs stress them as viable tools for developing countries with poor investment ratings, inherent infrastructure problems and burdensome bureaucratic procedures, to attract the necessary amount of FDI to jump start local economies. Foreign investors choose to operate in SEZs because of advantages offered by flexible, duty-free environments in addition to the reduction of insurance, security, and overhead costs. The requisite amount of FDI can then have spillover effects and lead to a multitude of secondary benefits for the local population. Jung Dong Park's examination of Chinese SEZs concludes that SEZs have had a remarkable impact on the influx of foreign capital, employment expansion, gain of foreign currency, growth of income and the rise of the living standards of people working in and around them. He adds, "The percentage of households with color TVs, a refrigerator, and a washing machine, all signs of improvement in quality of life, is higher in Shenzhen (where an SEZ is located) than in Beijing or Shanghai."⁷ A recent study of EPZs reveals, "EPZs are only one of the means of promoting economic development and encouraging industrial export that seems to have found favor among the governments of developing countries."⁸

Moreover, a 2008 study of SEZ's by the World Bank shows that SEZs are equally important to economies of developed countries like the United States, stating "they have been critical in enabling manufacturers to operate 'just-in-time' systems. In fact, most vehicles manufactured in the United States are located in FTZs or have factories provided with FTZ status."⁹ The argument follows that if FTZs are good for the United States, they are most certainly good for our neighbors in Latin America.

A second case for the development of Special Economic Zones is that they are designed for the specific purpose of enhancing trade. Indeed, arguments for trade and its benefits in creating economies of scale go back as far as David Ricardo's, "Principles of Political Economy and Taxation" in 1817. More recently, an article published by the

⁷ Jung-Dong Park, *The Special Economic Zones of China and Their Impact on Its Economic Development* (London: Praeger Publishers, 1997), 62.

⁸ Kwan-Yiu Wong and David K. Y. Chu, "Export Processing Zones and Special Economic Zones as Generators of Economic Development: The Asian Experience," *Geografiska Annaler. Series B, Human Geography* 66, no. 1 (1984): 13, accessed November 11, 2010, <http://www.jstor.org/stable/490524>.

⁹ Foreign Investment Advisory Service (FIAS), *Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development*, (Washington, D.C.: World Bank Group, 2008), 58.

Federal Reserve Bank of St. Louis outlines the specific benefits of removing protectionist barriers and increasing trade, concluding that the costs of protectionist methods far outweigh the benefits.¹⁰ A 2008 study sponsored by the World Bank reports, “There is little doubt that SEZs must continue to evolve in response to global integration, international trading rules, and the rise of regional FTAs.”¹¹ SEZs allow LDCs to participate more freely in trade regardless of protectionist methods established by the political framework of LDCs. This was the case throughout much of Latin America during the period of ISI and is largely still the case in China, despite the economic liberalization that has taken place. Moreover, in a speech given by WEPZA director Robert Haywood in 1995 to Latin American zone managers on the subject of EPZs in MERCOSUR, Haywood says, “Free Zones are a policy tool that helps your country or your region to become more competitive... in 15 years of working with EPZs I have never found another policy tool which has been more successful in stimulating economic growth in more diverse cultures, in more countries, in more situations.”¹² Many share Haywood’s enthusiasm for the implementation of SEZs, pointing to the diversification of exports it provides for a developing country. Costa Rica is often considered as a shining example of a country that was able to diversify exports with SEZs, moving from a largely agrarian economy to one that manufactures industrial goods, which allows Costa Rica to withstand international economic downturns when the demand of primary commodities goes down.

Despite a multitude of positive research, there are several cases against SEZs. Critics of SEZs point out that although SEZs seem good in theory, in practice have very little economic impact. Peter Warr points out that SEZs cannot be considered engines of development because their benefits are limited. For countries in the early stages of development, zones can be an efficient and productive means of absorbing surplus labor, however, most of the benefit found inside zones can and should be extended outside the

¹⁰ Cletus Coughlin, “Protectionist Trade Policies: A Survey of Theory, Evidence and Rationale.”

¹¹ FIAS, *Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development*.

¹² Richard L. Bolin, “Impact of 57 New Export Processing Zones in MERCOSUR,” Flagstaff Institute, 1995, 91.

zones without establishing these special enclaves.¹³ Kwan-Yiu Wong and David K. Y. Chu both criticize the performance of SEZs, claiming that given the magnitude of transformation most nations hope to gain, the impact of SEZs are moderate at best. They conclude, “It is quite clear that, at the present stage, SEZs can at most serve as laboratories to test western economic concepts in the process of modernization.”¹⁴

Additionally, there is considerable criticism that SEZs do not develop backwards linkages in host nations because they are often located in areas where there is already access to better infrastructure and availability to services and labor. A study of Costa Rican SEZs by the ILO surmises, “The Costa Rican experience indicates, just as the experience in many other countries, that the role that EPZs can play as a policy instrument to assist in the development of backward regions within a particular region is quite limited.”¹⁵ Special Economic Zones are also often criticized for the harsh labor practices engaged in them. The ILO reports that in countries across the world SEZ “workers tend to work longer hours than workers in other sectors of the economy, often in violation of national law.”¹⁶ Jean Pyle condemns EPZs stating, “increasing numbers of women have become sex workers, maids or domestics, and workers in export production networks—all largely female sectors—in order to earn incomes in the restructured global economy.”¹⁷

Further criticisms of SEZs concentrate on the security issue they present. A Financial Action Task Force report on the vulnerabilities of Free Trade Zones in 2010 highlighted the security concerns in these special enclaves. “The lack of transparency in the company formation process in SEZs permits companies located in SEZs to create

¹³ Peter G. Warr, “Export Processing Zones: The Economics of Enclave Manufacturing,” *The World Bank Research Observer* 4, no. 1 (1989): 85, accessed November 12, 2010, <http://www.jstor.org/stable/3986349>.

¹⁴ Wong and Chu, “Export Processing Zones and Special Economic Zones as Generators of Economic Growth: The Asian Experience,” 5.

¹⁵ Mauricio Jenkins, *Economic and Social Effects of Export Processing Zones in Costa Rica*, (Geneva: International Labor Office, 2003), 34–35.

¹⁶ International Labour Office, *Report of the InFocus Initiative on Export processing zones (EPZs): Latest trends and policy developments in EPZs*, (Geneva: International Labour Office, 2008), 6.

¹⁷ Jean L. Pyle, “Sex, Maids, and Export Processing: Risks and reasons for Gendered Global Production Networks,” *International Journal of Politics, Culture, and Society*, vol. 15, no. 1 (2001): 55.

layers of transactions which are difficult if not impossible for law enforcement to follow.”¹⁸ Phil Williams adds, “spaces typically known as free trade zones, are poorly regulated, give priority to facilitation rather than inspection, and are attractive to those operating in gray or black markets.”¹⁹ A detailed report published by the Library of Congress in 2003 on the security concerns of the Triple State Border Area claims, “Several free-trade Latin American areas with large Middle Eastern populations allow Islamic terrorist groups, organized crime mafias, and corrupt officials to thrive in a mutually beneficial, symbiotic relationship. These areas include Colombia’s Maicao, Venezuela’s Margarita Island, Chile’s Iquique, and the Tri-Border Area (TBA).”²⁰

There are clearly several factors that surround the cost-benefits for SEZs. Although there is a multitude of literature arguing for and against them, there are not enough detailed studies that outline the specific security aspects of Special Economic Zones in Latin America. A balanced inspection of SEZs, not purely from an economic or political standpoint, but also from the security dimension is needed. In this dimension it will be possible to focus on the interconnectedness of these SEZs and the dark networks they can potentially house. This policy paper will examine this dimension more clearly.

Special Economic Zones in Latin America are ultimately a balancing act between security and economic necessity. Although some argue in favor of SEZs and others shun them altogether, a moderate approach is needed given the political economy and context of Latin America as a developing region. Policies that specifically target security issues within the context of the Latin American political framework are important for regional and global security. By examining the case studies of Colon Free Zone (CFZ) and the TBA, this policy paper will determine which policies work, which ones do not, and what role the United States should play. Thus, the research in this paper begins with the hypothesis that policies that have improved security in the Colon FTZ can be applied to all SEZs in the region.

¹⁸ Financial Action Task Force, *Money Laundering Vulnerabilities of Free Trade Zones* (Paris: FATF/OECD, 2010), 20.

¹⁹ Ibid., 45.

²⁰ Hudson, *Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America*, 4.

C. METHODOLOGY

This paper will examine the vulnerabilities of SEZs in Latin America through a comparative case study approach focusing on two distinct SEZs. In addition to being in the same region, the SEZs chosen share attributes such as a similar colonial socio-economic history, poor infrastructure, and diaspora communities. By holding some of these variables constant, the dependent variable of security can be tested more closely. I will also analyze the situation with a historical background of the political economy followed by an assessment of the actors involved. By separating the actors into three categories—1) Economic/Political Actors, 2) Illicit Actors, and 3) Security Actors—a detailed picture of each FTZ and its vulnerabilities will emerge which will in turn inform the policies pursued by the host country, the international community and the United States. I will then use the case studies to analyze the level of security threat to the region as a whole.

First of all, the political economy of the SEZs will be examined through the lenses of neo-liberal and structuralist thought with respect to the Latin American development problem. A detailed look at the issue of globalization versus security will focus the context that surrounds SEZ development. Various textbooks, literature and popular schools of thought will be used to inspect the problem at the macro level, specifically, the effect of globalization on security and its related effects on terrorism. I will also reference periodicals, journals, and newspaper articles to substantiate claims and examine the issues from different perspectives. I will then switch focus to a micro-level approach by looking at the specific SEZs and their narrative within the political economy of the particular country(s) where the particular SEZ is located.

Finally, I will look at the policy outcomes each country has implemented and also take a look at what types of Theatre Support Cooperation (TSC) the United States has specifically engaged in to counter the threats in the SEZs. As part of this thesis I traveled to Asuncion, Paraguay with funding from the Marine Corps Intelligence Agency (MCIA) and conducted field research.

To summarize, this thesis will begin with an introduction to the historical and theoretical background of globalization and its effect on security with a decided focus on Special Economic Zones and their arrival to Latin America. The second chapter will thus describe the extent to which SEZs have proliferated and what makes them attractive to LDC's (Less Developed Countries). The third chapter will be a case study on the Colon FTZ, in Panama, the largest FTZ in the Americas. This case study will hopefully show which policies, primarily from the U.S. standpoint, have worked to solve some of the more salient issues. I will begin this chapter with a background of Colon and its political economy. Then I will describe the nature of the security concerns in the Colon and what makes this a unique FTZ in South America. I will further examine the Colon through the actors involved and conclude with policy recommendations on a domestic, regional, and U.S. level. The fourth chapter of this thesis will mirror this chapter but will examine the Special Economic Zone found in the TBA, hopefully taking some of the lessons learned from Colon and seeing what applies to the TBA and also seeing what the key variables are that make all SEZs tick. Finally, I will conclude with a chapter that explains the nature of the overall threat to the region and what implications these threats have for regional and U.S. policy. Specifically, I will examine the role that regional and international regimes play in the security of the SEZs as a whole from a three-tiered approach. I will also examine the impact that targeted U.S. TSC (Theatre Security Cooperation) has had on the SEZ security issue in Latin America.

II. SEZS: A CASE OF GLOBALIZATION VERSUS SECURITY

A. WHAT ARE SEZS?

Special Economic Zones have existed in some form or another since Gibraltar and Singapore became special economic city-states in 1704 and 1819, respectively. Nevertheless, the first recognized modern Free Trade Zone emerged in Shamrock, Ireland in 1959 when it was determined that a special economic enclave would help the disparate southern Irish economy get off the ground. The Shamrock FTZ was positioned at an international airport and special customs regimes were established to facilitate the introduction of raw materials and invite industrial manufacturing within the zone. Following the success of the Shamrock Zone, the SEZ concept rapidly spread to East Asia and Latin America, regions both considered early adopters of the SEZ concept. Arguably, however, SEZs in Latin America were established as early as 1942 in Puerto Rico, although it is generally agreed that the concept of a modern SEZ was not clearly established yet at that time. Thus, most countries in South East Asia and Latin America shifted paradigms from import substitution industrialization after World War II to that of export-oriented growth models. SEZs are an important part of this transition.

The basic principle behind an SEZ is the introduction of raw materials into the zones duty free, leaving taxes for the final exported product. Additionally, these zones allow foreign companies to establish themselves more freely within the zones by implementing loose regulations on land ownership, factory ownership and taxes. This paper will use the terminology and definition established by the 2008 FIAS report of Special Economic Zones, encompassing the range of modern free zone types (Figure 1). “SEZs are generally defined as geographically limited areas administered by a single body, offering certain incentives (generally duty-free importing and streamlined customs procedures, for instance) to businesses which physically locate within the zone.”²¹

²¹ FIAS, *Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development*, 2.

- **Free trade zones** (FTZs; also known as commercial free zones) are fenced-in, duty-free areas, offering warehousing, storage, and distribution facilities for trade, transshipment, and re-export operations.
- **Export processing zones** are industrial estates aimed primarily at foreign markets. Hybrid EPZs are typically sub-divided into a general zone open to all industries and a separate EPZ area reserved for export-oriented, EPZ-registered enterprises.
- **Enterprise zones** are intended to revitalize distressed urban or rural areas through the provision of tax incentives and financial grants.
- **Freeports** typically encompass much larger areas. They accommodate all types of activities, including tourism and retail sales, permit on-site residence, and provide a broader set of incentives and benefits.
- **Single factory EPZ** schemes provide incentives to individual enterprises regardless of location; factories do not have to locate within a designated zone to receive incentives and privileges.*
- **Specialized zones** include science/technology parks, petrochemical zones, logistics parks, airport-based zones, and so on.

Figure 3. Types of Zones²²

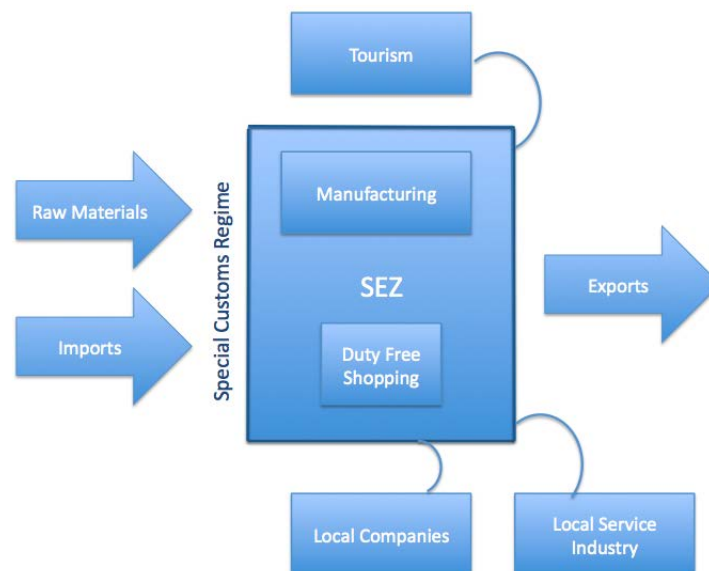


Figure 4. Special Economic Zone Model

²² FIAS, *Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development*, 3.

B. LATIN AMERICAN SEZs: AN ECONOMIC DEVELOPMENT TOOL

When framing the issue of SEZs in Latin America it is important to consider the context surrounding why and how they came about, where they fit in a globalized world, and what the specific criticisms are surrounding them as development tools. SEZs in Latin America are a part of the greater macro-economic issue of development economics whereby less developed countries (LDCs) pursue economic policies to attract foreign direct investment and grow the necessary linkages within their own respective economies. When considering SEZs as a development tool there are two competing schools of thought: 1) neo-liberal economics, which suggests that security in the third world can be achieved through free market and free trade economic reforms (The Chicago School, spurned from the so-called “Washington Consensus”) and 2) structuralism, which places an emphasis on building local economies from the ground up, suggesting liberal market policies invite a multitude of negative effects for local economies. Structuralists lean on government intervention and protectionism in order to grow national industry, and often cite the example of Germany’s development at the heavy hand of the state in the 1800s. Additionally, structuralists sympathize with dependency theorists who consider that third world nations are increasingly dependent on first world nations.

After World War II, development economics in Latin America often centered on structuralist approaches. During this period Latin American governments attempted to grow national economies behind protective tariffs and subsidization of local manufacturing, a process known as import substitution industrialization (ISI). These efforts often resulted in costly and inefficient production in addition to a waste of capital resources. In the 1960s and 1970s, when the idea of SEZs began to proliferate, governments in Latin America realized that development by way of ISI was an unproductive undertaking. Thus, many Latin American countries turned to the alternative strategy of export-oriented production, a much more neo-liberal approach. However, with a lack of capital, relatively poor technological expertise and little access to international markets, it was clear that inviting FDI was necessary. SEZs offered an attractive means for transnational corporations to take advantage of the new international division of labor,

found cheaply and abundantly in Latin America. It was also a way for Latin American countries to invite FDI without taking down the protectionist tariffs and subsidies that were already in place for the rest of the country (the enclave model).

Most Latin American governments approached neo-liberal reforms such as SEZ development with caution. Structuralism's core foundation in Latin America dated to the post-colonial period and the rich history of highly extractive economies at the hands of foreigners. Despite deep historical roots, structuralism was initially associated with Argentine economist Raul Prebisch and the UN's Economic Commission for Latin America (ECLAC) in the 1950s.²³ Although the structuralist theory was widely accepted by the UN and by economists like Aldo Ferrer, Celso Furtado, and Osvaldo Sunkel, due to the context of the Cold War and because structuralism was in direct competition with the "Washington Consensus" and free market neo-liberal views, it was frequently associated with Marxism. Andre Gunder Frank and Walter Rodney were stout proponents of the structuralism theory and they concentrated on the historical linkages of underdevelopment and economic stagnation to the bleeding of the industrialized core by economically developed nations as well as the entrenched oligarchy of third world nations. These economists recommend underdeveloped countries reduce their connectedness with the world market to pursue a path more in keeping with their own needs and not dictated by external pressure. Some Latin American countries like Brazil during the post-World War II era, for instance, elected to pursue economic policies in line with dependency theorists and structuralism by adopting ISI, firmly believing that by raising tariffs, minimizing foreign imports and walling off their economies, they could industrialize at the "Brazilian" pace.²⁴

On the other hand, French philosopher Marquis de Condorcet who argued that technological advancements and economic prosperity enable societal and cultural changes was one of the first to advocate for free market reforms. Condorcet was the first

²³ G. Honor Fagan and Ronaldo Munck, *Globalization and Security: An Encyclopedia Volume 1: Economic and Political Aspects* (Santa Barbara: Praeger Security International, 2009), 67.

²⁴ Patrice M. Franko, *The Puzzle of Latin American Economic Development*, 3rd ed. (Lanham: Rowman & Littlefield, 2007), 680, accessed February 11, 2011, <http://www.loc.gov/catdir/toc/ecip0618/2006025479.html>.

to connect economic and social development, emphasizing that LDCs would need to keep pace with an ever-changing world by seeking modernization through neo-liberal reforms. He encouraged technological processes and hypothesized that by modernizing human kind could gain control over their environments, thus correlating technological progress with social progress. His argument was part of a greater school of neoliberal political science fueled by popular economists like John Maynard Keynes and David Harvey who saw the capital accumulation after World War II as a sign that true free markets were needed for global economic prosperity.

French sociologist Émile Durkheim further developed Condorcet's concept by stressing the connectedness of institutions inside of a society and their importance in maintaining social unity. In his work, *The Division of Labor in Society*, he emphasized how social order could be maintained in a society and how less developed societies could "make the transition to more economically advanced industrial societies."²⁵ Durkheim suggested that in a capitalist society the complex division of labor and economic regulation were ingredients needed to maintain social order. Furthermore, Durkheim developed the idea of a social evolution, which stressed how societies and cultures develop over time through several stages, generally starting at a simplistic level and then developing into more complex ones. SEZs therefore represent a simple level of development that can occur between these stages.

David Apter took free market reforms a step further by concentrating on the political system and history of democracy, researching the "connection between democracy, good governance and the efficiency of modernization."²⁶ With these foundations laid, the basis for neo-liberalism evolved, which underscored the totality of change as a process of modernization that could spread throughout a society not only through economics, but also through types of government, social structure, values, and even religion.

²⁵ Emile Durkheim and W. D. Halls, *The Division of Labor in Society* [De la division du travail social], (New York: Free Press, 1984), 352.

²⁶ David E. Apter, *The Politics of Modernization* (Chicago: University of Chicago Press, 1965), 481.

At no period was neo-liberal economics and structuralism at greater odds with one another in Latin America than during the 1960s at the height of the Cold War. U.S. President John F. Kennedy took neo-liberal approach and emphasized the need for Washington to take the initiative in the Third World. Primarily concerned with the spread of communism in South East Asia and Latin America after the Cuban Revolution, Kennedy urged infusing economic and military aid to help national development and adopt counterinsurgency programs to fight the communist threat.²⁷ As part of this wider emphasis, the Kennedy administration also set up USAID in 1961 to coordinate government foreign aid initiatives, with a decided focus on Latin America.

As the world modernized and became more interconnected scholars began to replace the term “modernization” and “neo-liberalism,” with “globalization.” Scholars like Francis Fukuyama, Jagdish Bhagwati, Joseph Stiglitz, Martin Wolf, Thomas Friedman and Thomas Barnett viewed globalization as the convergence of civilization and a beacon for global security. These scholars and journalists claimed globalization as a powerful force for good in the world, providing connectedness across geographical, political, and cultural boundaries and providing great opportunities for “economic and social uplift in the poorest pockets of the globe.”²⁸ The positive effect of globalization is typically where SEZs are placed.

Critics of globalization and free markets focus on the fact that it has not always produced win-win results. Benjamin R. Barber argues that globalization is fundamentally at odds with civility and effective governing democracy. He sees the world as being undermined by the forces of “McWorld” and the pervasive existence of profit minded transnational corporations.²⁹ Political scientist Manfred Steger echoes these sentiments and adds, “globalization elevates market values over human values by creating sweatshops in poor nations to bring profits to large multinational corporations and by supporting conspicuous consumption by the wealthy, with Americans at the forefront of

²⁷ Fagan and Munck, *Globalization and Security: An Encyclopedia Volume 1: Economic and Political Aspects*.

²⁸ Forst, *Terrorism, Crime, and Public Policy*, 75.

²⁹ *Ibid.*, 83.

over-consumption of the world's scarce resources.”³⁰ At the heart of this argument is the realist belief that nations must protect themselves from external actors, both economic and political. A state must respond by developing policies to protect its borders from the infiltration of large multinational companies that abuse its citizens and rape the country of its natural resources.



Figure 5. SEZs: a Case of Globalization Versus Security

Despite a clear divide in Latin American developmental economics, many arguments in literature for and against SEZs can fall in either camp. SEZs as political and economic enclaves are the perfect example of where structuralism can meld with neoliberal market reforms. SEZs are also good examples of Latin American nations capitalizing on the globalization of capital and labor. The key policy question concerning SEZs becomes how to strike a balance between the positive effects of globalization with the multitude of security issues it invites. This is a key decision not only for domestic policy makers, but also for the region and the international community. Regardless, SEZs have spread throughout Latin America in a convincing manner (Figure 6).

³⁰ Forst, *Terrorism, Crime, and Public Policy*, 84.



Figure 6. SEZs in Latin America (Excluding Mexico)³¹

Turning to the security dimension, Thomas Barnett recognizes that globalization has its challenges, particularly within the framework of the U.S. military's defense strategy as it considers extending diplomatic engagement to countries moving from the periphery to the core. However, he clearly states that globalization has an overall net good affect. He argues that interconnected countries share norms and rules that bind people together and that globalization is at the forefront of the geopolitical formula for peace in the post 9/11 world. Barnett also argues that globalization is the "long-term solution to the problem of terrorism."³² He adopts a constructivist view that with

³¹ Data derived from ILO and WEPZA.

³² Forst, *Terrorism, Crime, and Public Policy*, 82.

globalization come institutions, regionalism, norms, and the rule of law. Much depends on geographic, economic, social and political background of the countries concerned.”³³

Turning to SEZs specifically, a moderate approach, neither structuralist nor neo-liberal, an approach that recognizes the security concerns but also acknowledges the political economy of LDCs and their incentive to modernize is needed. Wong points out that a case-by-case approach is needed to examine SEZs, but there is very little written that examines them in this way. Ann Clunan when describing the effects of globalization on security writes, “Today, a multitude of factors have forced the broadening of security to include human and global levels, not just the national... factors that include economic development, population movement, and disease diffusion; the rising interdependence in global finance and manufacturing; and the explosion in cross-border and intrastate societal interconnectedness through information and communications technology.”³⁴ SEZ’s provide an opportunity where “new terrorists,” actors are free to operate from the constraints of state sponsorship,³⁵ can conduct their illicit business with relative ease. “Terrorism financing is driven more by the availability of opportunities than by a shortfall in revenues from state sponsors.”³⁶ Thus, the incidence of poor governance, in SEZs, “state failure, and ungoverned areas explain the dominance of a ‘new’ financial model in which terrorists rely increasingly upon their own licit and illicit enterprises for their funding.”³⁷

The geographic proximity of terrorists and organized crime in the SEZ’s also allows possibilities for cooperation, the so-called “nexus” of organized crime and terrorism to take place. “Criminals and terrorists that share jail cells develop shared interests in joint criminal and terrorist ventures upon their release. This has been

³³ Wong and Chu, “Export Processing Zones and Special Economic Zones as Generators of Economic Development: The Asian Experience,” 13.

³⁴ Anne L. Clunan and Harold A. Trinkunas, *Ungoverned Spaces : Alternatives to State Authority in an Era of Softened Sovereignty* (Stanford, CA: Stanford Security Studies, 2010), 310.7.

³⁵ Jeanne K. Giraldo and Harold A. Trinkunas, *Terrorism Financing and State Responses: A Comparative Perspective*, (Stanford, CA: Stanford University Press, 2007).

³⁶ *Ibid.*, 10.

³⁷ *Ibid.*, 8.

documented not only in South Asia but also in the Madrid Bombings, in which a radicalized drug dealing organization played an instrumental role.”³⁸ By the very nature of SEZs as centers for trade and commerce, shared linkages allow criminals and terrorists to trade goods and people between them with ease. Smuggling, trafficking in persons, possible proliferation of WMD (or dirty bombs), drug trade, and terror financing are all bi-products of the permissive environments found in SEZs.

In the examination of the SEZs in this paper, the dimension of security will come to the forefront. There are clearly several stakeholders in SEZs, and illicit actors cannot be overlooked. SEZ’s, although not the traditional “ungoverned” space, may present an equally if not more challenging area for security actors to engage in. Ana Simons points out that “terrorists also need a modicum of stability, they wouldn’t set themselves up in a collapsed state where they potentially become a bargaining chip between local factions. Better to choose somewhere relatively calm and the kind of community that no authority would have the inclination, time or wherewithal to monitor.”³⁹ To be sure, SEZs can represent the “modicum of stability” that Simons points out, where illicit actors can enjoy the same economic benefits as legitimate actors (Figure 6).

³⁸ Giraldo and Trinkunas, *Terrorism Financing and State Responses: A Comparative Perspective*.

³⁹ Anna Simons and David Tucker, “The Misleading Problem of Failed States: A ‘socio-Geography’ of Terrorism in the Post-9/11 Era,” *Third World Quarterly* 28, no. 2 (03, 2007): 398, accessed March 5, 2011, <http://search.ebscohost.com/login.aspx?direct=true&db=sih&AN=24153026&site=ehost-live&scope=site>.

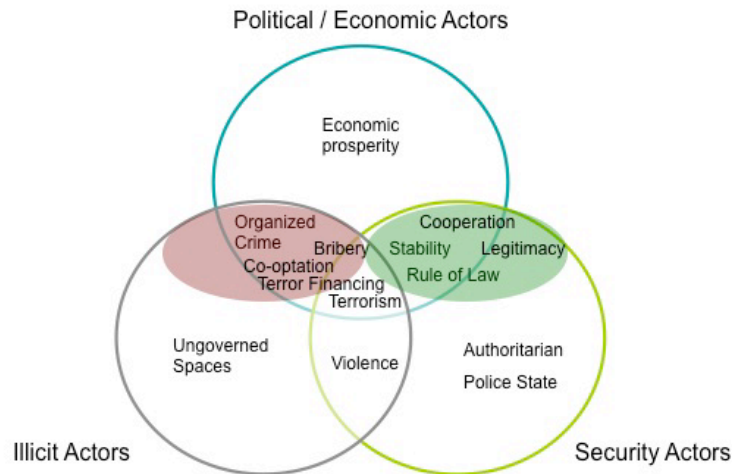


Figure 7. The Blend of Actors in SEZs

Figure 6 highlights the delicate balance within the political economies of SEZs. Where illicit actors encroach on the political and economic actors dimension is where organized crime, co-optation, bribery and terror financing (the red area) are found. Where Security actors encroach on economic actors you have stability, cooperation, and legitimacy, however, you may or may not have economic growth, particularly if security is too strong (the green area). The balance in an SEZ is to minimize the red area in favor of the green area, but also preferably establish an overall environment where security actors do not need to engage in violence. The ideal situation would be political and economic actors enjoying full economic prosperity without the need for a large security piece, however, as we hope to discover in this paper, this is not as easy as it sounds in Latin America. We will now turn to the examination of SEZs more closely by examining two case studies in the region: Colon and the TBA.

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III. COLON FREE ZONE CASE STUDY

A. INTRODUCTION AND BACKGROUND

Colon is often mentioned as the forgotten city of Panama, a desolate outpost built out of the boggy mangroves that even Christopher Columbus (after which the city is named) chose not to settle. Although much of Colon's history is filled with the hardships and sacrifices of its immigrant community, today those hardships and sacrifices have paid off, transforming Colon into what is now considered Panama's second city and home to the Colon Free Zone (CFZ), the largest free zone in the Americas and the second largest free zone in the world.

The transformation of Colon is a remarkable story that clearly illustrates the 'see-saw' game of globalization versus security. This case study will bring into focus the security dimension of a Latin American SEZ. The chapter will begin with a historical narrative that frames the issue followed by a close examination of the stakeholders in Colon's political economy. By separating the actors into the categories of: 1) Political and economic, 2) Illicit, and 3) Security, a clearer picture of Colon will emerge. This case shows that although the CFZ has many problems, the security dimension is vastly improved due in great part to internal and external political actors. Further policies will then be derived based a regional, domestic, and U.S.-centered focus.

Located at the Atlantic entrance to the Panama Canal on the banks of Limon Bay, today in one square mile, over 200,000 people live in Colon and its SEZ serves over 250,000 visitors a year, provides for 1,751 companies, generates exports and re-exports valued at more than US\$6.5 billion and a total trade volume estimated at

US\$19.167 billion.⁴⁰ Despite this remarkable success, unlike the skyscrapers and lively downtown buildings found in Panama City, in downtown Colon wooden construction still line its narrow cobblestone streets and poverty is still readily visible by turning a corner off the main drag. Many of the residential areas in Colon are in fact more than 90 years old, built to accommodate the thousands of West Indians brought to build the canal just after the turn of the century. Despite its economic transformation from swampy marshland to one of Panama's economic pillars, on Fifth Street, one of Colon's main thoroughfares, and an area also sarcastically referred to as "the Vatican," cocaine addiction, alcoholism, and delinquency are still pervasive issues. While the introduction of nearby cruise terminals and tourism has certainly changed Colon, the city maintains a harsh and edgy feel that has remained in its fabric throughout the years.

Today in Colon, smuggling and money laundering are still issues of concern. Its proximity to the United States and its location along drug trade routes through the Central American corridor are a magnet for illicit activities. Yet, Colon has also prospered and survived. The three main contributors to the transformation of Colon are the construction of the transcontinental Panama railway, the construction of the Panama Canal and the implementation of the Colon Free Trade Zone.

In 1850, when the Panama Railway Company chose Colon (then named Aspinwall) as the base of operations, the area was considered by most, including the government of Gran Colombia, who owned the Isthmus of Panama, to be extremely dangerous and unworthy of human inhabitation. The construction of the railway brought a floating population of immigrants from as far away as China and made it a popular stop for those seeking to cross the isthmus, particularly Americans in search of a western sea route. Colon's main economic engine in the 1800s came from the California gold rush and from the wayfarers who sought the easiest method to cross the isthmus on their way to San Francisco. However, the unforgiving physical environment of Colon made it infamous for its unsavory living standards and illicit activities. The three most thriving industries in Colon in the mid-1800s were gambling, prostitution, and coffin

⁴⁰ BBC Monitoring Service Latin America, "Panama's Colon Free Zone ended 2009 with positive figures," January 19, 2010.

manufacturing.⁴¹ Perhaps a most disagreeable fact was that Colon began its trade prowess as a world leader in cadaver exports, where corpses of the unidentified West Indian or Chinese laborers who perished from exposure to disease were shipped off to scientific laboratories or universities around the world. Compared to Colón, wrote one French journalist, “The ghettos of White Russia and the slums of Toulon or Naples would appear models of cleanliness.”⁴²

The next step in the development of Colon came at the hands of the French in 1880, when it became the main hub of operations for engineers working on the first proposal for a Panama Canal. The French occupation revitalized business and infrastructure development as more of the marshes on Manzanilla Island were drained to provide for housing. Businesses sprang up to accommodate the new communities sent to work on the Canal, however, Colon’s vices and notorious elements of crime and disease persisted. The French eventually abandoned the idea of building a canal in 1889 when reportedly more than 22,000 workers died of malaria, yellow fever and other diseases.⁴³ When Americans took over the construction of the Panama Canal in 1904, after a U.S. backed Panamanian declaration of independence from the Republic of Colombia, Colon’s economy was revitalized and it experienced a new wave of immigration from the West Indies. After the construction of the Panama Canal was completed in 1914, Colon saw a relative decline of investment despite the American military bases that dotted the country from the entrance to Limon Bay to the Pacific coast. The American government took charge of the Canal and an area 10 miles on either side. That said, most of Colon was untouched by Americans and under the sovereign rule of the Republic of Panama.

The final phase in the development of Colon was the establishment of its Free Trade Zone in 1948. With the close of World War II, Panama faced an economic downturn and the Panamanian government was under increasing domestic pressure to provide employment and economic opportunities for its population. Then President of

⁴¹ David McCullough, *The Path Between the Seas: The Creation of the Panama Canal 1870–1914*, (New York: Simon and Schuster, 1977).

⁴² Ibid., 75.

⁴³ Ibid., 75–85.

the Republic of Panama, Enrique A. Jimenez approved the Decree Law N°. 18 of June 17, 1948, establishing the Colon Free Zone (CFZ) as an independent arm of the Panamanian State, with its own legal representation and autonomous regimes. This was a concerted effort by the Panamanian state to stimulate FDI and commerce. With a privileged geographic position at the entrance to one of the most traveled sea-routes in the world and with exceptional port facilities left over after the World Wars, Colon quickly grew to one of the greatest import and re-export zones (entrepot) in the world.

Yet, despite the best intentions, Colon's Free Zone continued to attract nefarious characters that would use the liberal market regimes for their own illusive profits. Indeed some of the disreputable characters include Panamanian officials, of which perhaps most notorious was former Panamanian dictator General Noriega. General Noriega was implicated in wire transfers from banks, money laundering, drug smuggling and even sending out classified materials to Cuba through the CFZ.⁴⁴ He was also accused to have a substantial interest in a bank in the CFZ, which was found to be heavily involved in laundering money for the M-19 as well as for narcotics dealers.

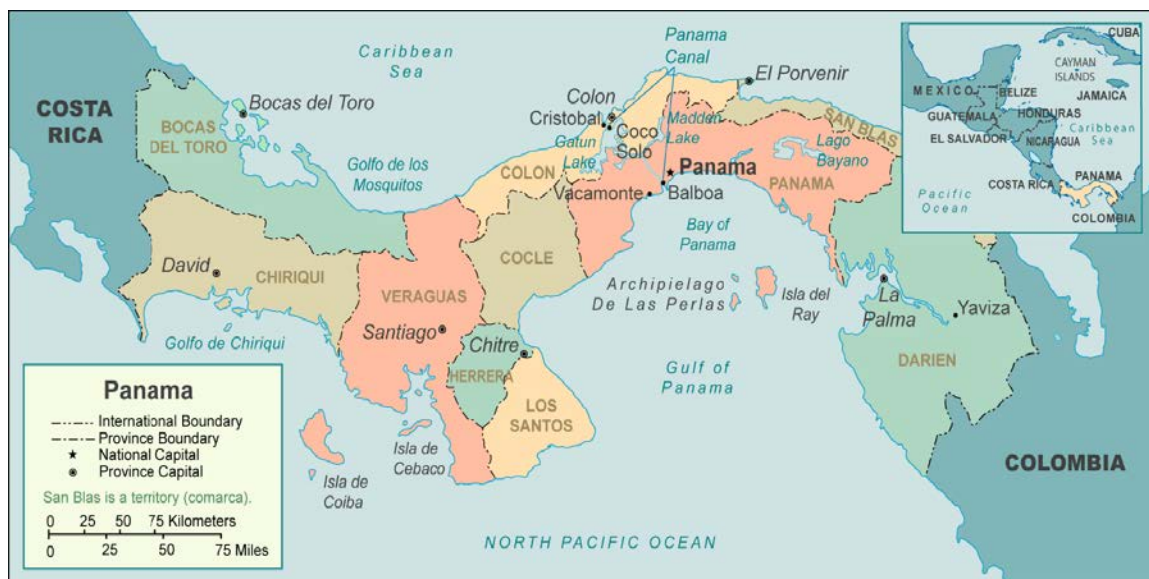


Figure 8. Colon's Strategic Location

⁴⁴ Seymour M. Ersh, "Panama Strongman Said to Trade in Drugs, Arms and Illicit Money," *New York Times*, June 12, 1986, accessed May 16, 2011, <http://search.proquest.com/docview/425921977?accountid=12702>.

B. SECURITY ISSUES

As the world's second largest SEZ (largest in the Western Hemisphere), the Colon Free Zone (CFZ) is uniquely vulnerable to a multitude of security issues due to the enormity and volume of trade and business that takes place within its borders. In 2010, there was approximately 2586 businesses established in the CFZ, it employed about 28,000 people, imported and re-exported about \$16B worth of goods, and traded approximately 913.5 thousand metric tons worth of cargo. With a zone of this size, distinguishing between legitimate and illegitimate business can be a challenge, especially in a country that was ranked by Transparency International 73rd in the world in freedom from corruption, and where the shadow economy is estimated to be worth approximately 65% of the country's overall GDP.⁴⁵

One of the more pervasive issues of the CFZ is its proximity to the illegal cocaine trade based out of the Andean countries of Colombia and Peru. Approximately 88% of the cocaine and marijuana bound for the United States is reportedly transiting through the Central American corridor,⁴⁶ and it is estimated that 54 tons⁴⁷ of cocaine are smuggled through the CFZ and Panama enroute to the US and European markets. In 2009, over 600 kg of cocaine were seized in two operations carried out in the Colon province. The shipment in question, which originated in Colombia, was transferred, repackaged and hidden in corn flour containers headed for Spain.⁴⁸ Drug traffickers and organized crime have historically used small craft, container ships, and aircraft to move illicit drugs through Panama. Some of the drugs are then transferred to land-based vehicles to transit through Central America or are placed in sea-freight containers in the CFZ for transport on large cargo vessels. Traffickers also take advantage of the hundreds of abandoned and unmonitored airstrips in the vicinity as well as personal couriers transiting Panama by

⁴⁵ Fredrich Schneider and Dominik H. Enste, "Shadow Economies: Size Causes and Consequence," *Journal of Economic Literature* vol. XXXVIII (March 2000): 80.

⁴⁶ United Nations Office on Drugs and Crimes, *Crime and Development in Central America: Caught in the Crossfire*, United Nations Publication, May 2007, 12.

⁴⁷ Mark P. Sullivan, *Panama: Political and Economic Conditions and U.S. Relations* (Washington, D.C.: Congressional Research Service, 2011), 14.

⁴⁸ BBC Monitoring Service Latin America, "Panama authorities seize over 600 kilos of cocaine hidden in corn flour shipment," May 6, 2009.

conventional commercial air flights to smuggle drugs through the border. In addition, Panama has an increasing domestic drug abuse problem, particularly between the growing middle class and youth, who are later indoctrinated into organized crime.

Furthermore, drugs are not the only illicit trade happening in Colon. Panama was also placed on the State Department's Tier 2 Watch List for trafficking in persons (TIP) in 2008 for "failing to show evidence of increasing efforts to combat human trafficking and for failing to provide adequate victim assistance."⁴⁹ Conceivably, Colon's direct trade route to U.S. ports like Miami also makes it a place susceptible to WMD trafficking. The U.S. Government Accountability Office (GAO) also listed Panama as one of 50 countries described as having "tax havens" or "financial privacy jurisdictions according to a number of international organizations."⁵⁰

Possible links to terror financing is a concern in the CFZ derived from both legitimate and illegitimate businesses, whereby funds are then routed to the respective terror organizations through remittances. Colon is home to a sizeable Arab and Palestinian population suspected to support terrorist activities like those of Hamas and Hezbollah, according to a 2002 U.S. State Department report entitled, "Patterns of Global Terrorism." In an interview with La Prensa, a former president of the Colon Chamber of Commerce of Arab descent named Gassan Salama questioned the U.S. State Department's report and defended Palestinian businessmen in Colon stating, "The sympathizers have increased as a result of the latest terrorist act undertaken by the Zionist state of Israel against the Palestinian civilian population. The Palestinian businessmen established in the ZL (Zona Libre) are supporting—in a moral sense—the just cause which is the return of the land to its owners."⁵¹ These types of sentiments are undeniably a red flag for U.S. officials hoping to disrupt remittances from flowing towards terror organizations.

⁴⁹ U.S. Department of State, "Trafficking in Persons Report," June 2010. Also see: Clare Ribando Seelke, "Trafficking in Persons in Latin America and the Caribbean," *CRS Report RL33200*.

⁵⁰ J.F. Hornbeck, *The Proposed U.S.-Panama Free Trade Agreement* (Washington, DC: Congressional Research Service, March 1, 2011).

⁵¹ Victor D. Torres, "Empresarios Acusan a EU de querer destruir la Zona Libre," *LaPrensa.com*, accessed May 1, 2011, <http://mensual.prensa.com/mensual/contenido/2002/05/26/hoy/portada/572774.html>.

Finally, and most persistent, the CFZ is widely criticized for its money laundering vulnerabilities. Between \$1 billion and \$4 billion is laundered annually in the CFZ.⁵² Liberal business practices invite illicit actors, particularly those involved with the drug trade, to use the Colon Free Zone as a method to establish front businesses to escape customs, law enforcement and to launder dirty money. Utilizing trade-based money laundering tactics, like the Black Market Peso Exchange (BPME), narcotics traffickers are able to move proceeds from drug sales in the U.S. and Europe to destinations in the Andes. Trade based money laundering, such as under-invoicing allows organized crime to avoid tariffs and conceal the true origins of their proceeds. Moreover, Panama's poor regulatory practices allow illicit actors to invest in real estate without the need for construction permits, thus allowing them yet another avenue to launder money in the booming real estate market found in Panama.

C. THE ACTORS

1. Political/Economic Actors

Panama is relatively new to the democratic process. For most Panamanians, the 1989 overthrow of dictator Manuel Noriega remains a fairly recent memory. For the better half of a century, the United States has played a key role in shaping the sovereignty of Panama. Yet, although the United States controlled the Panama Canal, a special zone 10 miles on both sides, and numerous military installations until 2000, the Colon Free Zone remained an exclusively Panamanian entity. Thus, in many ways, the CFZ represents a piece of sovereign Panama that was allowed to develop a uniquely Panamanian way. This key dynamic coupled with economic necessities influences many of the current government and economic policies in Colon.

⁵² William J. Walker, *The Relationship and Threat of Transnational Organized Crime, Drug Traffickers and terrorist Groups in the Western Hemisphere: The Hot Spots* (Washington: Inter American Defense College: April 2006), 34.

First of all, it is important to consider that the CFZ is an enormous contributor to the Panamanian economy, which is heavily dependent on a well-developed service sector, accounting for 75 percent of GDP.⁵³ Services in the Panama economy include the Panama Canal, the Colon Free Zone, banking, insurance, container port facilities, and flagship registry. Over US\$12 billion of goods are imported and re-exported every year through the CFZ. Despite the duty free shopping, the CFZ is primarily a credit-driven economy because of the dollarization of Panama and the lack of a Central Bank. Dollarization actually began in Panama with the construction of the Panama Canal when canal workers were paid in U.S. dollars. Panama effectively surrenders monetary policy to the US Federal Reserve, which has limited Panama's rate of inflation, facilitated trade with its largest trading partner, and enhanced foreign investors' confidence in the economy.⁵⁴ The dollarized economy unique to Panama attracts foreign banks, which prefer it to the overly bureaucratized public banking systems found in other parts of Latin America. Consequently, the need for issuing credit in the CFZ provides a significant source of revenue for banks operating in the Panamanian financial sector. It is no surprise why Panama is considered the financial capital of Latin America. As former Chicago School of Business graduate, Finance Minister, and President of Panama, Nicolas Barletta noted, "The Free Trade Zone and the banking system are totally symbiotic."⁵⁵ Thus, the financial sector in Panama is heavily dependent on the credit needs of multinational corporations in Colon, and vice-versa.

The CFZ's importance to the overall health of the Panamanian economy means officials are increasingly reluctant to impose new rules that would make Colon less attractive to regional and international traders. For instance, in the 1990s at the height of the war on drugs, Panamanian officials staunchly argued that any illicit cash flowing through the CFZ mostly reflected efforts by traders in a liberalized regional economy to evade tariffs and taxes rather than to launder cocaine profits, despite the numerous arrests

⁵³ CIA World Fact Book: Panama.

⁵⁴ R. Rhys Jenkins, "The political economy of industrialization: a comparison of Latin American and East Asian newly industrializing countries," *Development and Change Journal* 22 (1991): 197–231.

⁵⁵ Nicholas Barletta, *Veinte Anos del Centro Bancario y Sus Proyecciones* (Panama City: Universidad del Istmo, 1998).

and convictions to the contrary.⁵⁶ Going back to the arguments brought forth in Chapter II, the political and economic actors invested in the CFZ are striking the balance between globalization and security, but heavily leaning towards globalization.

Historically, the CFZ's investors have been large multinational firms from the United States, Japan and Europe. Panama remains the world's second largest home to foreign registered companies behind only Hong Kong, with some 350,000. Some of the best known include U.S. Multinational companies that have incorporated in the CFZ like Hanes and Nike, but there are many other U.S. brands that chose regional distributors to get their product to market. Perhaps one of the most significant trends lately is the increased amount of FDI in the CFZ from Venezuela. The diversity of FDI in the CFZ is a testament to its economic attractiveness.

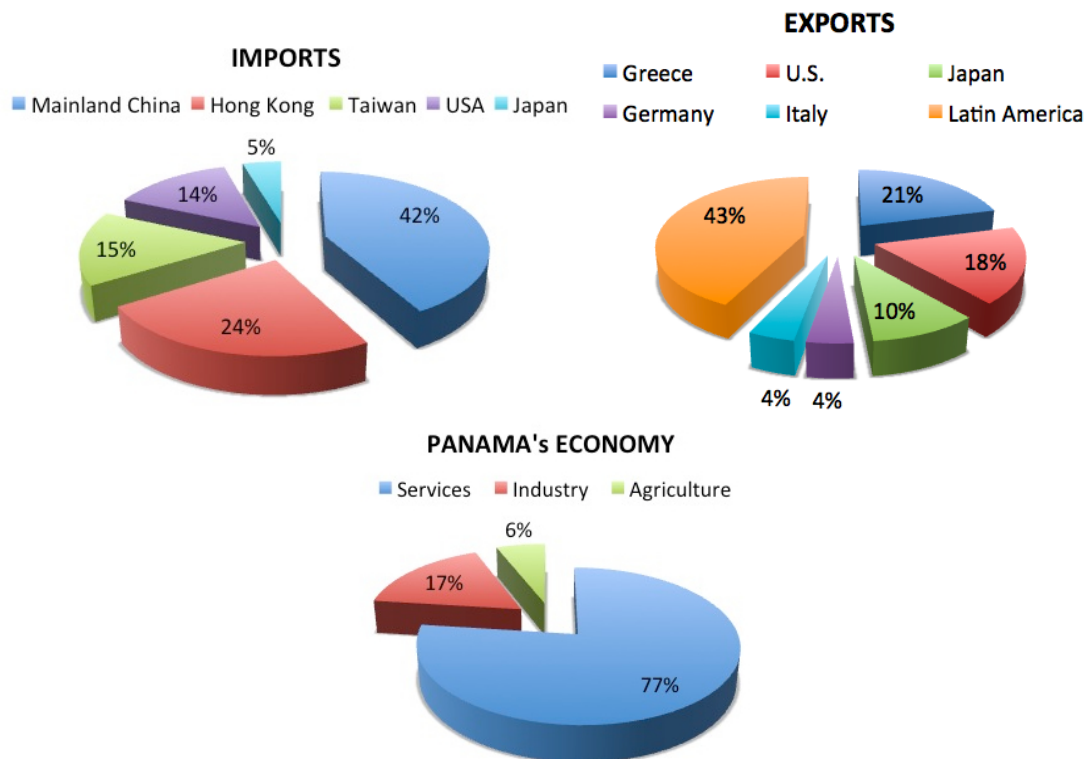


Figure 9. Panama's Economy⁵⁷

⁵⁶ "Panama Still a Conduit For Cocaine Profits," *The Washington Post*, September 20, 1993, 2.

⁵⁷ Data obtained from CIA World Factbook.

More recent developments show the increasing use of the CFZ as a cash cow for government projects. In 2005, Panama's legislature passed a fiscal reform package to raise revenues from taxes and reduce public debt. The measures established a new 1.4% tax on company gross revenues and a 1% flat tax on firms operating in the Colon Free Trade Zone. Additionally, new and unprecedented tax measures passed in 2010 enforces a 5% VAT on domestic exports from the zone. These measures prompted violent clashes between police and worker unions, where 200 people were detained.⁵⁸ However, the new tax laws were seen by the government as a necessary evil to help finance projects such as the Panama Metro and Canal expansion.⁵⁹ "Over the next five years, the Martinelli administration will dedicate more than US\$13 billion to public investments in education, roads, airports, mass transport and other sectors."⁶⁰ In 2004 alone, the CFZ produced \$22 million in direct revenues for the government and the new tax measures of 2010 are expected to increase government revenue by more than 2%, according to the International Monetary Fund.⁶¹ Interestingly, the Panamanian government, which historically leaned towards lenient tax measures, has recently stepped up their ability to capitalize on zone profits by instituting these fiscal reforms.

The Panamanian government is also responsible for keeping the CFZ competitive in world markets. From 2004–2009 Panama's GDP grew an average of 8%, and is expected to continue to grow at an average of 5% for 2010–2015.⁶² Economic growth despite a global recession is a convincing argument for political and economic actors to continue investment in the CFZ. The CFZ's year after year growth is impressive. After a 12.1% growth in 2007 and 10.1% in 2008, some economists predicted that the economy would contract in 2009. However, Panama's economy ended up growing 3.2%, surprising most and making Panama's economy one of the few in Latin America to

⁵⁸ Mark P. Sullivan, *Panama: Political and Economic Conditions and U.S. Relations*, (Washington: Congressional Research Service, March 2011), 7.

⁵⁹ *Ibid.*, 7.

⁶⁰ Ministerio de Economía y Finanzas Republica de Panama, "Panama's Investment Outlook: Investment Grade and Beyond," 2009, 16.

⁶¹ International Monetary Fund, "Panama: 2010 Article IV Consultation—Staff Report," October 2010, IMF Country Report No. 10/314.

⁶² Economist Intelligence Unit, *Country Report: Panama*, London, February 2011, 13.

register positive economic growth in 2009. In 2010, the economy's growth approached 7%, and the forecast for 2011 is over 6%.⁶³ Maintaining these growth figures has become an important political tool for politicians and also for large multinational firms seeking to capitalize on increasing commerce and better infrastructure developments.

Domestic needs are also important when considering the CFZ's political economy. Put simply, it employs 28,000 workers in a country with an unemployment rate near 14.5% as of 2004.⁶⁴ Panama's economy is characterized by a fusion of a sizeable outward-looking service sector and a small, inward-oriented manufacturing sector. An autonomous institution of the Panamanian government administers and manages the CFZ, making the strategy of zone development heavily predicated on government policies and internal economic needs. The CFZ is an example of the state-led growth model that other Free Zones like Jeb Ali in Dubai have employed with a great deal of success. An example of the Panamanian government's inward policies in the CFZ are the Panamanian laws stating every corporation must hire at least 5 Panamanian nationals and offer tax credits for corporations based on the percentage of Panamanian workers employed. Inward structuralism measures like the ones mentioned have allowed President Martinelli to retain high approval ratings, measured at over 70% in December 2010.⁶⁵

In recent years, the CFZ has taken some decidedly regional strides both politically and economically. In 1997, Zone manager Campagnani responded in an interview saying, "We want to become the world's showroom for Latin American export products not only for its import products."⁶⁶ Zone Authorities and government of Panama (GOP) officials are still hoping that linkages and technology transfer will apply to the domestic sector of the economy and increase Panama's leverage over its neighbors. In a recent

⁶³ Economist Intelligence Unit: *Country Report: Panama*.

⁶⁴ Santiago Fittipaldi, "Free Zone Shortfalls," *Latin Finance* (2005): 1, accessed May 16, 2011, <http://search.proquest.com/docview/195969727?accountid=12702>.

⁶⁵ "Re-Election Motion Chucked Out in Panama," *Latin News Daily*, January 6, 2011.

⁶⁶ Raymond Collitt, "A PANAMANIAN PROFIT PARADISE: Companies operating in one of the world's largest free trade zones now enjoy a complete income tax exemption," *The Financial Post*, October 14, 1997.

interview with President Martinelli concerning the rapid emergence of Venezuelan companies in the CFZ, he responded, “Panama can not have poor relations with any of its Latin American brothers or any country in the world” he continued, “although we have some political differences, there is nothing personal between us.” Martinelli said he also has good relations with Nicaragua’s President Daniel Ortega.⁶⁷

2. Illicit Actors

Since its inception Colon’s underbelly has seemingly always lured hustlers and smugglers. Its ports and waterfront offer easy access the Caribbean, to countries like Cuba, Venezuela and Colombia, and its laissez-faire attitude attracts subversive ambitions of all sorts. Nevertheless, the illicit actors in Colon can be characterized into three main functional areas: 1) smugglers (mostly narcotics but also trafficking in persons and weapons), 2) terror financiers, and 3) money launderers. Certainly, the CFZ is conducive for actors to participate in all three illicit activities, which makes it a veritable one-stop shop for organized crime. In this section, the conduct of illicit actors will be described in more detail.

The Central American corridor is now the preferred method to smuggle illegal narcotics to the U.S. market. In the days when Colombian cartels ruled the market, air and sea routes over the Caribbean were the preferred methods to get product to the United States. However, now that Mexican drug cartels control distribution, land and sea routes that hug the Central American coast are the preferred method to get cocaine into the North American continent.⁶⁸ This means that a vast majority of cocaine and heroin will find its way through Panama. In 2009, according to an INCSR report, 54 metric tons and \$11 million in cash linked to drug trafficking were seized in Panama.⁶⁹ Although

⁶⁷ BBC Monitoring Service Latin America, “Panama President stresses importance of ties with Venezuela,” July 9, 2010.

⁶⁸ United Nations Office on Drugs and Crimes, *Crime and Development in Central America: Caught in the Crossfire*, 15.

⁶⁹ Sullivan, *Panama: Political and Economic Relations and U.S. Relations*, 14.

Colon may not be the actual hub of operations for drugs going to the United States, there is definitely a considerable amount that flows through its ports in route to Mexican, U.S. and European distributors.

U.S. and Mexican officials have been aware of this problem for some time, but its magnitude is coming into better focus now. In the 1990s, for example, after seizing 1.5 metric tons of cocaine, Mexican officials alerted Panama's government that a company in the CFZ was involved in the shipment. A Panamanian businessman confessed and was imprisoned. However, the U.S. government later learned the businessman had been inexplicably released from jail.⁷⁰ The use of Panama as a transshipment point is also believed to contribute to the alarming increase in violence. "The murder rate climbed from 11.1 homicides per 100,000 persons in 2006 to a projected 23.2 per 100,000 in 2009. Panamanian authorities attribute the deteriorating security situation in large part to the increase in narcotics trafficking."⁷¹

Today, seizures of cocaine found in Panamanian-registered cargo vessels in ports like Valencia, Spain and Miami, Florida are not uncommon. Moreover, the FARC (Revolutionary Armed Forces of Colombia), a Marxist terrorist organization based out of Colombia that uses the narcotics trade for funding, is perhaps one of the most notorious organizations to operate within the CFZ and in larger Panama. The FARC is implicated in numerous cases of smuggling from the CFZ. Recently in April 2011, Panamanian customs agents seized 140 kilograms of cocaine in Colon. National Police Director, Gustavo Perez informed members of the press that cocaine was found packaged inside the compartments of a ship originating from Colombia, with Mexico as its final destination.⁷² Members of the FARC are describes as coordinating with Mexican and Colombian drug cartels in the operation.

⁷⁰ Steve Coll and Douglas Farah, "Panama Still Conduit for Cocaine Profits," *The Washington Post Foreign Service*, December 20, 1993.

⁷¹ United States Department of State Bureau for International Narcotics Control and Law Enforcement Affairs, *International Narcotics Control Strategy Report, Volume 1 Drug and Chemical Control*, March 2010, 501.

⁷² "Officials Make Drug Bust in Colon," LaPrensa.com, April 1, 2011, accessed May 11, 2011, http://mensual.prensa.com/mensual/contenido/2011/04/01/hoy/english/news_6727.asp.

The State Department's Country Reports on Terrorism in 2009 stated the main terrorist concerns in Panama were the presence of the FARC in the Darién, a dense jungle region between Panama and Colombia, and their potential actions against the Panama Canal.⁷³ Although terrorist acts are likely in Panama City, the FARC's motives in Colon are financial rather than ideological. The FARC primarily uses Colon as a method to smuggle weapons and drug profits to finance terrorist operations in native Colombia. However, kidnapping, extortion, and smuggling as are also methods of concern. The State Department's report also claimed members from the guerrilla group's 57th Front operated in the Darién and continue to use it as a safe haven for drug trafficking. The 57th front is also linked to the kidnapping of a U.S.-Cuban citizen near Panama City in April 2008 who was held for ransom until February of 2009. Potential targets for ransom include wealthy individuals who are deemed capable of paying large sums. High Net Worth Individuals (HNWIs), "persons with large assets often in the range of \$50 to \$100 million"⁷⁴ that shelter their funds in Colon through the complicated maze of holding companies, are particularly vulnerable to kidnappings. Although Panama extradited several FARC members to the United States for prosecution in 2009, "three FARC members were killed and two were captured in a clash with Panamanian forces in the Darién as recently as January 2010."⁷⁵

Terror financing for other groups besides the FARC are also a problem in the CFZ. Terror Financiers of Lebanese and Arab descent are believed to have infiltrated the large duty free shopping areas associated with the CFZ where businesses engage in selling fake copyrighted materials. It is estimated that 24,000⁷⁶ Muslims live in Panama, primarily concentrated in Colon, although this figure is a rough estimate. Numerous Arab businessmen in Colon have been accused of intellectual property violations. In fact, entire lines of Oster home appliances and Sony PlayStations are frequently discovered in

⁷³ U.S. State Department, *Country Reports on Terrorism 2009*, Office of the Coordinator for Counterterrorism; Chapter 2: Western Hemisphere Overview, 2009.

⁷⁴ Ibid.

⁷⁵ Ibid.

⁷⁶ Pew Research Center, *Mapping the Global Muslim Population: A Report on the Size and Distribution of the World's Muslim Population* (Washington: Pew Forum on Religion and Public Life, 2009) 33.

containers and in duty free shops in Colon. In July 2003, Interpol Secretary General Ronald K. Noble testified to the House of Representatives Committee on International Relations that intellectual Property Crimes is prevalent in South America. Noble added, “Walid Zayed, jailed in Panama for money laundering, is the infatida representative for Latin America.”⁷⁷ Noble said Zayed admitted to meetings with terrorist groups in the 1990s and that proceeds from fake products found their way into terrorist’s hands. Zayid is also the author of the book entitled, “Palestina arde el silencio,” where he describes the legitimate cause of sending remittances to help the terror organizations fight the Zionists. In fact, Panama’s first money laundering trial in 1996 was against five Lebanese entrepreneurs. The men were charged with laundering 3.5 million dollars in drug money through the CFZ by changing foreign currency into U.S. dollars through front companies.⁷⁸ Larry C. Johnson, of the antiterrorism consulting firm of Berg Associates LLC, also testified that a counterfeit operation with connections to terrorist organizations is still thriving in Colon Free Zone.

Money Laundering is the most pervasive issue in the CFZ. The use of the dollar in Panama is one of several reasons the country is attractive as a money-laundering center. The CFZ forms an integral part of the Colombian Black Market Peso Exchange (BPME), a system that sprung up after the Colombian government banned the use of the U.S. dollar, thus creating a black market for dollars in Colombia necessitated by drug proceeds in the United States. The exact process was described in a UN report as, “a trade-based laundering mechanism ... where illicit dollars in cash are sold at a discounted exchange rate to Latin-American importers who then use them to purchase goods in the CFZ. CFZ merchants can be willingly or unwillingly used to receive that cash and deposit it in their bank accounts as legitimate proceeds from real sales.”⁷⁹ In other words, the BPME is a money laundering operation through which narcotics proceeds

⁷⁷ Edwin M. Delaney, Claire E. Goldstein, Jennifer Gutman, and Scott N. Wagner, “Interpol Chief Informs House Committee That Intellectual Property Piracy Finances Terrorism,” *Intellectual Property & Technology Law Journal*, vol. 15, no. 10 (October 2003): 21.

⁷⁸ United States State Department, *International Narcotics Control Strategy Report 1996*, Bureau for International Narcotics and Law Enforcement Affairs, Washington: March 1997, 28.

⁷⁹ United Nations Office on Drugs and Crimes, *Crime and Development in Central America: Caught in the Crossfire*, 69.

earned in the United States are exchanged for Colombian pesos and then used to purchase goods in the Colon Free Zone. These goods can then be legally shipped to Colombia out of the CFZ, in effect cleansing the dirty money. Recent assessments carried out by the United Nations and the IMF also identified a growing problem of under invoicing products imported from Panama and its CFZ and linked this practice to money laundering. In an effort to stifle this, Colombia set port restrictions and required advance import declarations for products coming from Panama and the Colon Free Zone.⁸⁰

A BPME case discovered recently involved two jewelry companies in the CFZ found as the result of a money laundering investigation of narcotics proceeds from the United States.⁸¹ More than 40 million worth of gold, silver, and other jewelry were seized by DEA agents and transferred to Texas by U.S. Air Force C-130s with the help of Panamanian officials. The investigation led to a first groundbreaking U.S. indictment of an offshore business engaged in the BPME. “During the course of the investigation, Yardena Hebroni and Eliahu Mizrani were identified as major money launderers based in Panama. Hebroni and Mizrani used a wholesale jewelry business, Speed Joyeros S.A., and a related company identified as Argento Vivo S.A., to facilitate their illegal money laundering activities.”⁸² This case was the first bilateral U.S./Panama investigation resulting in a CFZ company’s assets being seized and the owners brought to justice in the United States. Both Hebroni and Mizrani are serving sentences for money laundering in the United States.

The U.S. Treasury department’s Office of Foreign Assets Control (OFAC) has also recently designated 2 CFZ-based companies, Goldi Electronics S.A. and Zona Libre International Market S.A., as pieces of an extensive money laundering scheme by Aiman Said Joumaa. Joumaa and his organization based in Lebanon launder proceeds from illicit activities in the CFZ and in other SEZ’s around the globe.

⁸⁰ World Trade Organization, *Colombia – Indicative Prices and Restrictions on Ports of Entry: Report of the Panel*, April 27, 2009, 1-5.

⁸¹ “More than \$40 Million Worth of Gold, Silver, Jewelry Forfeited in International Money Laundering Case,” US Fed News Service, Including US State News, April 13, 2010, accessed May 17, 2011, <http://search.proquest.com/docview/473171478?accountid=12702>.

⁸² Ibid.

Co-opted politicians that have a helping hand in illicit activities are also pervasive in the CFZ and in Panama. As mentioned earlier, Manuel Noriega used companies in the CFZ for his illicit activities, and he was not the last politician to do so. Panama continues to suffer the effects of a myriad of high-level corruption scandals. The outgoing president, Mireya Moscoso, was recently stripped of her political immunity over allegations that \$70 million of public spending went unaccounted for under her administration. Of the \$70 million in question, she admitted using \$3 million in public funds for her own personal effects. Before her, Panamanian President Ernesto Pérez Balladares was accused of selling visas to Chinese Panamanians trying to get into the United States illegally. After learning of these accusations the US government revoked his visa. These cases were just two of many that marred the administrations of the former two presidents and continue to affect Panamanian politics today.⁸³ Cases of corruption at the highest levels of government have spillover effects in the CFZ, which is an arm of the GOP.

The former Moscoso administration shares many linkages to corruption. Members of her cabinet and closest advisors like Roberto Eisenmen (also former head of Transparency International in Panama) were major shareholders of Dadeland Bank of Florida when it was discovered as a laundering center for large amounts of drug money.⁸⁴ Alvin Weeden, a notorious money-launderer known by U.S. authorities, was confirmed as Panama's Comptroller General from 1999 to 2004. In 1993, "Weeden and Customs chief Rodrigo Arosmena were named by former Panamanian Attorney General Rogelio Cruz, himself tied to drug cartels, as suspects in the disappearance of several containers of ethyl ether belonging to the Panama Canal Commission, which ended up in the hands of Colombian Cartels. Ether is used to extract cocaine from coca leaves."⁸⁵

Corruption in Panama is still pervasive, although things seemed to have quieted down a bit. Whether the Trojillos administration was and the current Martinelli administration is now corrupt is a matter of debate. There is little doubt that Martinelli is

⁸³ United States State Department, *International Narcotics Control Strategy Report 1996*, 85.

⁸⁴ Carlos Wesley, "Dope Inc. is Back in the Saddle in Panama," *EIR*, vol. 26, no. 40, October 8, 1999.

⁸⁵ *Ibid.*

continues to use heavy-handed state policies in the pursuit of development. There are still many accusations of bribery taking place with members of the Martinelli administration, but for the moment Panama's economic success and socialist programs put in place to put money in the hands of the poor have contributed to the popularity of the current regime.

3. Security Actors

Panama has laws regulating money laundering, terror financing, and numerous pieces of legislation governing SEZ administration. In fact, its laws on money laundering have pioneered laws in other Latin American countries thanks to substantial U.S. pressure. In 1998, Panama conceded to U.S. demands for increased penalties for drug trafficking, established extradition procedures and officially made money laundering a crime. These measures included subscribing to the guidelines provided by the Caribbean Financial Action Task Force to combat money laundering and terror financing. Tendering to CFATFs norms forces Panama to monitor bank accounts more closely, collect suspicious deposit activity, file suspicious transaction (STRs) reports, and makes freezing bank accounts of suspected laundered funds possible. Decided U.S. unilateral efforts also compelled Panama to sign the Mutual Legal Assistance Treaty (MLAT) in 2010, which lifted confidentiality in the case of suspected money laundering. This treaty is especially important in order to deal with Panama's banking secrecy laws and has improved law enforcement cooperation with the United States. Other participants in the MLAT include the Cayman Islands, the Netherlands Antilles, the Turks and Caicos Islands, Turkey, and Switzerland. In July 2010 Panama became a member of the FATF's South America region GAFISUD, moving from the Caribbean Financial Action Task Force to the GAFISUD because the FATF believed Panama shared more goals and problems with the GAFISUD members on money laundering than Caribbean members.

Panama has also made significant progress on improving the transparency of its financial sector. The GOP has maximized its efforts to seek its removal from the OECD's grey list for money laundering. The newly signed Tax Information Exchange Agreement (TIEA) with the United States, along with Double Taxation Treaties (DTTs) with 13 other OECD members in 2010, are landmark events in a country where banking privacy

laws have made cooperation difficult. The Organization of American States (OAS) and its Anti-Money Laundering Unit (AMLU) obtained these efforts with a decisive push. The measures are also an effort to reduce the ability for corporations and individuals to use the CFZ and Panama's banks as tax havens. Additionally a new banking law (Law 33) is helping the GOP fight money laundering by allowing the sharing of banking information with foreign tax authorities pursuant to TIEA requests.⁸⁶ Also, in October 2010 a new law (Law 67) requires the declaration of cash valued at \$10,000 or more when leaving the country. This law in particular has slowed the amount of cash leaving the country through the airport, which is especially applicable as Copa airlines has expanded its reach to many more South American destinations. To enforce the new laws Panama has grown its Judiciary powers as well. There are now approximately 9,000 lawyers and company service providers in Panama.⁸⁷

Substantial tax reforms over the last decade have also made a dramatic impact in Panama and in the CFZ. For instance, Law No. 8 of 2010 allows the Panamanian State to capture more revenue and improve its security sector. Under the new tax laws any legal entity that is required to obtain a business license in a Free Zone is taxed at a rate of 5%, which is still better than the 10% for Panamanian sourced income in the rest of the country, and thus still offering a competitive advantage for businesses locating within the zone. Exemptions apply to licensed multinational companies headquartered in the zone and to companies whose operations take place abroad with no links to the Panamanian market.⁸⁸ These tax measures hope to capture more of the informal market that takes place around the CFZ. Although there is a delicate balance keeping the CFZ competitive with other SEZs in the region, especially those that offer better tax incentives, the CFZs connectedness with rail lines and port facilities, its consolidation of product lines, and the expeditiousness with which companies can operate, keeps it competitive despite lower

⁸⁶ U.S. Department of States Bureau for International Narcotics and Law Enforcement Affairs, "Money Laundering and Financial Crimes Database," May 2011, 280.

⁸⁷ Organization for Economic Cooperation and Development, "Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer Review Report Phase 1: Legal and regulatory Framework," Panama, 2010, 13.

⁸⁸ *Ibid.*, 11.

fiscal advantages offered in other zones. These tax reforms have led to an upgrading of Panama's investment grade credit rating and also helped the overall attractiveness to foreign investors looking to relocate to one of Panama's SEZs.⁸⁹

Panama has also made vast improvements to security measures in the CFZ by increasing its maritime interdiction capacity and law enforcement arms. In July 2008, Panama's National Assembly empowered President Torrijos to carry out security sector reforms. President Torrijos enacted five laws reorganizing Panama's law enforcement and security services, which established a National Border Service (SNF) and a National Intelligence and Security Service (SENIS). Some critics fear that these heavy-handed state actions will lead to Panama's eventual re-militarization, while Torrijos maintained security sector reforms are needed to combat narco-trafficking and terrorists.

Additionally, changes to the penal code have increased penalties for the illegal possession of firearms and introduced stiffer sentences for attacking police officials.⁹⁰ In 2008 a merger of the National Air Service (SAN) and the National Maritime Service (SMN) into a unified service called the National Aero-Naval Service (SENAN) streamlined its ability to conduct interdiction operations, particularly on the Caribbean coast where the CFZ is located. The GOP also created SENAFRONT, a separate frontier police from the PNP, thus establishing an independent entity in the hopes of creating an effective border security force. In February 2010, current President Martinelli "announced an expansion of the national police force with an additional 4,000 officers that would raise the total force to over 15,000."⁹¹

Along with better native security forces Panama is increasingly open to theatre security cooperation with its neighbors and the United States. In late 2010, Panama and Colombia agreed to establish police stations near each side of the border in order to combat narco trafficking and the FARC. Panama and the United States also continue to participate in a yearly tabletop exercise named PANAMAX that fosters joint operations

⁸⁹ "Panama: Credit Update," *EIU – Business Latin America*, March 29, 2010.

⁹⁰ Sullivan, *Panama: Political and Economic Relations and U.S. Relations*, 5.

⁹¹ "Panama Politics: President's Popularity Slips," *EIU ViewsWire*, March 23, 2010.

with many other Latin American militaries in defense of the Panama Canal in the event of terrorist attack and narco trafficking incursions. The United States and Panamanian forces also corroborate in training events designed for participants to practice skills necessary to combat terrorism and illicit trafficking. A Joint Combined Exchange Training program consists of mission planning, tactical communications, marksmanship, first aid, air mobility and other special operations skills. U.S. Ambassador to Panama, Phyllis Powers noted “We are working side by side with our Panamanian counterparts to create safe streets and strengthen the law enforcement infrastructure with an integrated approach that includes training, logistical support, information sharing, and providing positive opportunities for youth at risk. Joint trainings like this provide another way in which we support Panama's goals of alleviating crime and fighting narco-trafficking.”⁹²

CFZ officials on their own merit have made ardent strides towards improving the security of its zone. The CFZ has remained a fully enclosed commercial area under the supervision of customs and other law enforcement agencies. Both the Colon Free Zone User’s Association and the CFZ Administration have established a strict code of conduct that argues that illicit activity needs to be policed by individual companies, stressing that a bad reputation hurts those dedicated to making the CFZ a world-class trading center. Accusations of an infraction can lead to a suspension of the business license needed to operate in the zone. Efforts to minimize cash transactions have also helped with the traceability of funds both legal and illegal. “Cash accounts for only 10% of transactions and there is careful monitoring of all goods that move in and out of the zone through electronic tracking systems.”⁹³

In 2009, the CFZ Authority launched two projects designed to increase transparency and accountability in its SEZ. The first effort consisted of an automated transactions system to replace an antiquated manual system with limited reporting and analysis ability. The second effort was a compulsory money laundering and terrorist financing on-line training module for all companies operating in the zone. The GOP and

⁹² “Panama and U.S. Security Forces Conduct Training,” *Targeted News Service*, Mar 14, 2011, accessed May 17, 2011, <http://search.proquest.com/docview/858680995?accountid=12702>.

⁹³ Hornbeck, *The Proposed U.S.-Panama Free Trade Agreement*, 11.

CFZ Authority in 2009 also agreed to participate in the Container Security Initiative (CSI) at three ports: Balboa, Manzanillo, and the Evergreen Colon Container Terminal. The CSI strategic plan brought forth by the U.S. Customs and Border Patrol (CBP) is a comprehensive regime where containers are pre-screened, and with the use of technology like x-ray machines, where high-risk containers are submitted to more stringent examination without slowing down the movement of trade.⁹⁴ Additionally, the U.S. Department of Energy as part of the Mega Ports program, established radiation portals at the ports of Manzanillo and Balboa. These portals specifically scan for nuclear and radioactive materials in the effort to neutralize WMD proliferation. The construction of a third and fourth portal is nearly completed at the ports of Colon and Cristobal.

The CFZ Authority also claims a newly established automated network with links to Panama's Customs Service and related government agencies will reduce red tape, cut costs for zone tenants and speed up transactions, which in the past were conducted by messengers shuttling between offices. The security plan also calls for closed-circuit cameras throughout the 400-hectare complex, deployment of security patrols along the zone's shoreline and stepped-up controls at CFZ access points. The goal is to improve the area's security and prevent goods from exiting the zone illegally.⁹⁵

In Panama, the security dimension has been improved, especially in the last few years. This has led to the encroachment of security actors into the overall political economy. Although illicit activity still persists, the sizeable security sector can either stabilize the situation or produce violence. As of yet, things remain stable, and the hope is that eventually illicit actors will be driven out.

⁹⁴ U.S. Customs and Border Patrol, "Container Security Initiative 2006-2011 Strategic Plan," 2005, 2.

⁹⁵ Fittipaldi, "Free Zone Shortfalls."

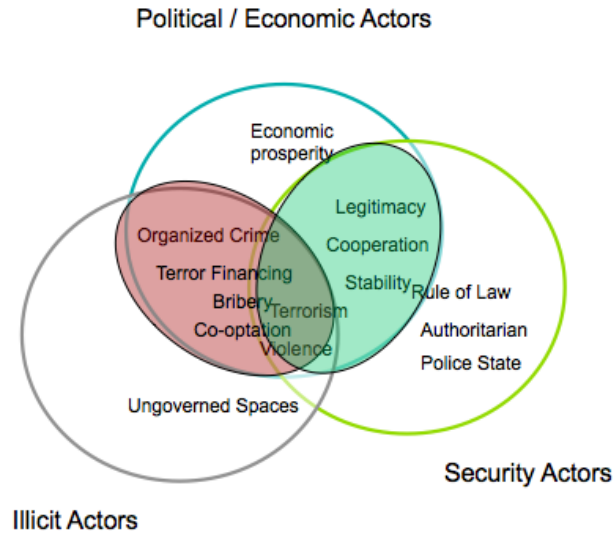


Figure 10. The Colon SEZ

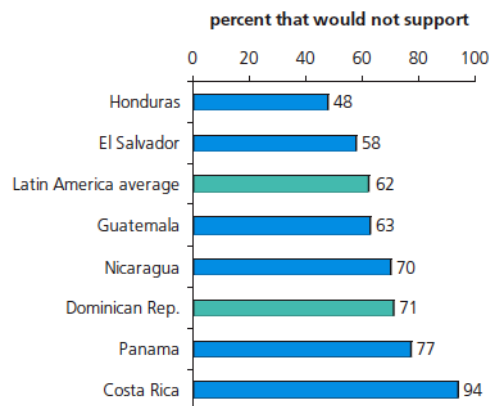
D. POLICY DETERMINATION

1. Domestic

Panama currently has a substantial security dimension in place for the Colon Free Zone. There are also extensive national laws condemning nearly all illicit activities that take place in the CFZ. However, many of the legal parameters, as discussed in the previous section, are laws that have been implemented very recently in the last two years. This leaves some room to grow for the implementation process to be effective in the face of entrenched illicit behaviors. As it pertains to security specifically in Colon, although increasing police forces will certainly help, they are not needed as much as the effective use of improved technology and a strong judiciary to go after criminals. Panama's justice system is still weak and susceptible to the corruptive influences of drug traffickers. Security reforms need to continue with efforts that improve public sector accountability and transparency. Thus, domestic recommendations for Panama fall more on the execution side than on the policy side.

The first step is to create sustainable and credible law enforcement. Indeed, the GOP's security sector reforms have created a much more capable force for handling drug smuggling throughout the country, especially in some of the less governable areas in the Darien and along the northern coastline. Furthermore the maturation of a Public Ministry, implementation of the Technical Judicial Police (PTJ) and the development of a Panama National Police (PNP) mobile inspection unit has improved the ability for discovering smuggling cases and quickly bringing them to trial. The problem sometimes occurs once the criminals are caught, as some of the cases get caught up in lengthy legal battles and bureaucracy.

The Martinelli administration has also created 11 air and naval anti-drug bases since 2009 in an effort to curb narcotics trade.⁹⁶ That said, Martinelli needs to be careful with how much "militarization" is perceived to take place among the Panamanian people. Panama's rich history of military rule is unpopular among most Panamanians and a return to a militarized state is a fear people undoubtedly share. It is also a fear Martinelli's opposition will seek to exploit in upcoming elections in 2014. A poll conducted by Latinobarometro shows Panama's lack of support for a centralized military as compared to some other Latin American nations.



Source: Latinobarometro 2005

Figure 11. Panama's Trepidation of Militarization

⁹⁶ "Panamanian Minister Says Foreign Anti-Drugs Aid 'Nothing Substantial'," *BBC Monitoring Americas*, September 30, 2009; and "Panama's Naval Air Stations Not Covert U.S. Military Bases – Minister," *BBC Monitoring Americas*, December 6, 2009.

Although police can play a vital role in security, they need to be de-militarized in the context of Panama's historical narrative to be effective. It is imperative for police as well as other domestic security actors to be free from corruption and trusted by their community. Security forces must convince the public that it is worthwhile to report crimes than to take matters into their own hands or paying someone to take care of their problems with violence. This "bypass the state" mentality needs to end and trust needs to extend to the judiciary as well. The growing number of lawyers in Panama and state prosecutors must be trusted to not take bribes and actually interpret and uphold laws. Ultimately, law enforcement and judiciary are the most visible element in the state's efforts to address crime issues, and in order to handle the criminal elements in the CFZ they need to have support of those they serve.

Modernization of its security services, in particular to go after financial crimes and money laundering, is the most fundamental domestic need in the CFZ. The Money Laundering and Financial Crimes Data Base published by the U.S. State Department in 2011 claims the CFZ continues to be vulnerable to illicit financial activities in part because of the following practices:

The ease of third party payments made by an intermediary apparently unrelated to the seller or purchaser; use of amended internal credit documents without reasonable justification; customers not required to produce appropriate documentation (e.g., invoice) to support a requested transaction; significant discrepancies exist between transport document information and the invoice; the long-awaited electronic transaction recording information system is operational but not widely used – a total of 5,000 keys to the electronic system were provided to CFZ companies, but most continue to submit transaction information in hard-copy format ; and, the ease with which bulk cash can be brought into Panama through the main international airport by declaring it is for use in the CFZ.⁹⁷

Despite Panama's willingness to comply with regional and international conventions on financial crimes, and also despite new laws passed to prevent some of the issues that are still deficient, concerted efforts on the implementation side are still needed. For instance, several anti-money laundering regulatory bodies within Panama do

⁹⁷ U.S. State Department, *Money Laundering and Financial Crimes Country Database, Volume I*, May 2011, 180.

not communicate well. Panama's FIU (the Unidad de Analisis Financiero), the Superintendencia, Banker's Association, and Customs, for instance, do not share databases or a means to cooperate. Better training on the use of new electronic measures, continued efforts with the CSI program at its ports, and efforts to professionalize the security sector by providing better pay and incentives should continue to improve things in the future.

2. Regional

Panama should continue to cooperate with its neighbors in combating the security issues in the CFZ. The drug smuggling problem through the Central American corridor is a regional problem that will require cooperation amongst states. Regional cooperation is also paramount to fighting the issue of money laundering, particularly since much of the money laundering in the CFZ is based on false invoicing and other trade based mechanisms that involves international trade.

Panama has bilateral agreements on counter narcotics with the Colombia, Mexico, Cuba, and Peru. Panama should seek to establish new bilateral agreements with other Central American nations and also with Venezuela, a major investor in the CFZ. More bilateral agreements will resolve transparency issues and improve security dialogue, and it is particularly important to engage Venezuela who is rapidly becoming the largest investor in the CFZ. Panama-Venezuela relations will likely begin to play a larger role in the CFZ, as some of the more pervasive issues will need cooperation between these two nations.

As a member of the Organization of American States (OAS), Panama is "party to the Inter-American Convention on Mutual Assistance in Criminal Matters, the Inter American Convention Against Corruption, the Inter-American Convention of Extradition, the Inter-American Convention against Terrorism, and the Inter-American Convention against the illicit manufacturing of and trafficking in firearms."⁹⁸ Panama is also an active participant in the U.S.-SICA (Integrated System for Central America) security

⁹⁸ Organization for Economic Cooperation and Development., "Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer Review Report Phase 1: Legal and regulatory."

dialogue, which ties Central American nations together in security cooperation. As a member of FATF's GAFISUD, Panama has also agreed to abide by the FATF's 40 recommendations against money laundering and 9 special recommendations against terror financing. Continued membership of these regional bodies and efforts to seek cooperation with its neighbors is an important part of the security piece in the CFZ.

3. U.S. Recommendations

The United State's physical influence in Panama has waned since the 2000 military pullout and hand over of the Panama Canal. That said, today, about 27,000 U.S. citizens still reside in Panama, mostly retirees of the former Panama Canal Commission who reside in the western part of the country.⁹⁹ There are also several U.S. businesses that are spread out between Colon and Panama City. According to the most recent IRS data, 159 U.S. corporations, 18 of the 100 largest publicly traded companies and 14 out of the 100 largest federal contractors have subsidiaries in Panama.¹⁰⁰ Therefore, although U.S. footprint is smaller than it once was, there remain unequivocally more U.S. interests in Panama than in many other parts of Latin America. The current U.S. relationship with Panama is characterized by extensive multi-agency cooperation on counter narcotics, military assistance to secure the Canal, and money laundering/counter-terrorist financing efforts in Colon. These efforts have been successful and should continue in order to ensure U.S. assets in Panama are protected and to defend U.S. borders from drugs and WMD infiltration.

As part of the Mérida Initiative, U.S. bilateral assistance to Panama amounted to \$3.7 million in FY2008, \$7.6 million in FY2009, and \$7.3 million in FY2010. For FY2011, the Obama Administration requested \$10.6 million in assistance for Panama, including \$7.5 million in Development Assistance and \$2.1 million in Foreign Military

⁹⁹ U.S. Department of State, "Background Note: Panama," September 16, 2010, accessed May 12, 2011, <http://www.state.gov/r/pa/ei/bgn/2030.htm>.

¹⁰⁰ U.S. Government Accountability Office, "International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Haven or Financial Privacy Jurisdictions," *GAO-09-157*, December 18, 2008.

Financing (FMF).¹⁰¹ These efforts show the United States' recognition of the security problems facing Panama and how they also relate to the protection of U.S. interests. In the CFZ, U.S. resources need to be focused on correcting the issues of modernization and training of the security forces that are already in place.

U.S. Interagency efforts of the Department of Homeland Security (DHS), the U.S. Military's Office of Defense Cooperation (ODC) in Panama, and the U.S. Coast Guard continue to provide resources for modernization and upkeep of SENAN, SENAFRONT, and PNP vessels, bases and aircraft. These agencies should also continue to assist SENAN with training personnel in the use of new technology in the CFZ. For instance, CBP and DEA vetted teams have helped with the Tocumen Airport Drug Interdiction Law Enforcement Team to improve airport security measures. Concentrated efforts like these should continue and should translate to the CFZ where focused training on new x-ray machines, gamma machines, and electronic invoice systems should be conducted. . The DEA and U.S. Immigration Customs Enforcement (ICE) vetted units should continue with their efforts to implement new software and computerized methods to track trade based money laundering and financial crimes (the TTU Units). Also, continued law enforcement training for the quick response motorcycle teams ("lynx" units) and in Tactical Law Enforcement procedures, internal affairs, and in anti-Corruption investigations will help the CFZ become more transparent.

U.S. policy and external pressures have conformed Panama and the CFZ to abide by international regulations on money laundering, terror financing, and narcotics smuggling. Although many of the recent laws passed need better implementation, the security sector to do it is in place and it is a matter of executing it for it to be successful.

¹⁰¹ Sullivan, *Panama: Political and Economic Relations and U.S. Relations*, 12.

IV. TBA CASE STUDY

A. INTRODUCTION AND BACKGROUND

The Triple-State Border Area (TBA) is home to one of the most beautiful natural landscapes in the world: the Iguazu Falls, portrayed in several Hollywood productions and Hong Kong kung-fu movies. Curiously, Iguazu Falls was also the subject of a poster found hanging in the abandoned home of an alleged top Al Qaeda operative in Kabul, Afghanistan in 2002.¹⁰² At this frontier where Paraguay, Brazil, and Argentina meet, young men on motorcycles cross the “friendship bridge” several times a day, ferrying shoppers looking to score a deal on everything from cheap electronics to illicit “Paraguayan brown” (the local marijuana). Although easily smuggling an AK-47 purchased for \$375¹⁰³ in Ciudad del Este across the border to a hotel room in Brazil certainly raises concerns, as the poster in Kabul suggests, there are even more serious problems found in the TBA.

Not surprisingly, despite the picturesque backdrop of this natural wonder, the nearby cities of Ciudad del Este and Foz do Iguazu provide a thriving black market that fuel transnational organized crime and terror networks. These criminals and terrorists represent a serious security issue because their ability to smuggle goods across borders has surpassed current law enforcement measures and challenged the legitimacy of state and regional institutions. Additionally, evidence shows that the TBA is a major hub for weapons trafficking, drug smuggling, terror financing, and potentially an avenue for WMD proliferation. Although there is certainly no easy solution, by examining the TBA in the same fashion the CFZ was in Chapter III, a framework can be established to put forth policies. This study will show that the TBA lacks the security dimension to function as a viable SEZ.

¹⁰² Hudson, *Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America*.

¹⁰³ Jeffrey Goldberg, “In the Party of God,” *The New Yorker* 79, no. 32, October 28, 2002.

The TBA's history is riddled with questionable motives and peculiarities, particularly on the Paraguayan side of the border. During the nineteenth century all three TBA countries fought wars to defend or expand their borders. The War of The Triple Alliance (1864-1870) was the bloodiest of these, devastating Paraguay's population by as much as 60 percent and nearly wiping out the entire male population.¹⁰⁴ Thus, the most important aspect of the TBA for most of the twentieth century were the military bases established by the governments of the three nations to secure national territory and protect natural resources.¹⁰⁵ The TBA was a desolate outpost for many decades, mostly populated on the Brazilian side of the border, however, the introduction of hydroelectric power and the establishment as a Free Trade Zone status in Ciudad del Este transformed and marked its evolution.

The city of Foz do Iguacu, Brazil, was established in the late nineteenth century as a military colony. In the early twentieth century, most of the 2000 people that lived in the territory were sugar mill workers, military families, or farmers.¹⁰⁶ By 1914, however, a wave of civilian migration from the rural areas of Brazil and also immigrants escaping war and famine in Western Europe and Palestine altered the area's demographics. When the Itaipu Dam was constructed many of the farmers that were displaced eventually left Brazil and Foz do Iguacu for lands in Paraguay. These farmers and their offspring are often referred to as "Brasiguayos" and continue to play a prominent role in the social fabric of the TBA.¹⁰⁷ The Brazilian city of Foz do Iguaçu now has a population of about 320,000 and is the largest of the three TBA cities. It is considered to have a higher standard of living than Ciudad del Este and is therefore where prominent shopkeepers and business owners tend to live. It is also the second most popular tourist destination in Brazil after Rio de Janeiro.

¹⁰⁴ Marshall C. Eakin, *History of Latin America: Collision of Cultures* (New York: Palgrave, 2007).

¹⁰⁵ C. Ferradás, "How a green wilderness became a trade wilderness; the story of a Southern cone frontier," *Political and Legal Anthropology Review* 21(1998): 11–25.

¹⁰⁶ Jose Carlos Aguiar, "Stretching the Border: Smuggling practices and the Control of Illegality in South America," *New Voices Series*, no. 6, October 6, 2010.

¹⁰⁷ *Ibid.*, 8.

In 1957, Paraguayan dictator Alfredo Stroessner changed the dynamics of the TBA when he established a trade frontier along the border with Brazil's Foz do Iguacu and named it after himself, Puerto Presidente Stroessner. His mission was arguably what he termed, "marcha al este" ("march to the east") in an effort to establish a buffer against expansionist Brazil.¹⁰⁸ By offering economic incentives as well as constructing a road to link the new town to the capital in Asuncion he hoped to introduce a Paraguayan population to the TBA, ensuring the nation's sovereignty. However, his plan lacked proper planning and technical assistance necessary to establish education systems, health care, and any basic infrastructure. From its inception, the city was founded on a basis of smuggling and exportation of contraband materials into Brazil, especially during the 1960s and 1970s, a period when Brazil exercised an economic policy of ISI (Import Substitution Industrialization).¹⁰⁹ ISI was part of the Brazilian government's strategy to grow national industries by raising import tariffs to shield domestic markets (see Chapter II for more complete discussion). Although this strategy helped industrialize certain sectors of the Brazilian economy, it also raised prices on goods and consumables.

To take advantage of the situation, Stroessner established over 200 clandestine airfields in the surrounding area of the TBA and along the porous borders with Brazil in order to smuggle cheap goods into the Brazilian economy, fields that are still used to today by narcotics smugglers.¹¹⁰ At Stroessner's urging, Brazil agreed to build the Puente de la Amistad ("Friendship Bridge") in 1962 to link the Paraguayan city of Puerto Presidente Stroessner and Foz do Iguacu. He also simultaneously declared the city a "zona libre" (free zone), with certain economic privileges.

As consumer demand for cheap foreign goods reached an all-time high in Brazil, especially during the late 1970s and early 1980s, when the global financial crisis hit the Brazilian market with disastrous effects, Stroessner and his supporters made tremendous profits on the smuggling operations in the TBA. Thus, a mutual clientelistic relationship

¹⁰⁸ Gilberto Ruiz Carvalho, "El Portentoso Alto Parana: Sus grandezas y deventuras," Papyru's Impresiones, 2010, 118.

¹⁰⁹ Franko, *The Puzzle of Latin American Economic Development*.

¹¹⁰ Sebastian Junger, "Terrorism's New Geography," *Vanity Fair*, no. 508, December 2002, 196.

developed between the Paraguayan government and the businesses in Puerto Presidente Stroessner (now Ciudad del Este). Corruption was encouraged as lucrative profits soared and business pay-offs channeled through a few government officials. Arguably, a black market developed in Ciudad del Este before the introduction of legitimate businesses.

Ciudad del Este is now the second largest of the three TBA cities with a population of nearly 250,000, also making it the second largest city in all of Paraguay behind Asunción.¹¹¹ Although the entire city of Ciudad del Este is considered a free zone, a formal SEZ was established according to Decree 17003 of 24 April 2002, when the consortium of Transtrade S. A. and Associates was awarded the rights to manage Zona Franca Internacional by the Government of Paraguay pursuant the activities and regulations defined in the Free Zone Regime of Paraguay Law enacted in 1995. Despite these laws, Ciudad del Este and its “free zone” are largely comprised of duty free shopping areas throughout the city where illicit activities are allowed to promulgate.

The city of Puerto Iguazu, Argentina, is the farthest physically, economically and socially from the previous two. With around 30,000 inhabitants, Puerto Iguazu is considerably smaller than its peers in Paraguay and Brazil with tourism related to the Iguazu Falls is at its core economically. Puerto Iguazu was founded in 1901 in order to open access to the Iguazu Falls from the Argentine side. In 1985, the Tancredo Neves Bridge was opened to little fanfare compared to the Friendship Bridge that Paraguay and Brazil share. The bridge traverses the Iguazu River and connects Argentina to Brazil, facilitating transportation and the movement of goods from the SEZ located in Ciudad del Este into Argentina, and to a newly established SEZ on the Argentine side named Zona Franca de Puerto Iguazu (ZFPI). However, the distance to the other two major urban centers, among other things, prevents the true commercial integration of Puerto Iguazu to the rest of the TBA. Additionally, the varying customs policies of the three countries contribute to the segmented configuration of the area. While the passage from Foz do Iguacu to Ciudad del Este occurs rather simply by crossing the Puente de Amistad, it takes approximately 15 minutes by narrow road and customs checkpoints to reach the

¹¹¹ Phillip K. Abbot. “Terrorist Threat in the Tri-Border Area: Myth or Reality?.” *Military Review*: September-October 2004.

border with Argentina, which can take an additional 25 minutes to traverse. Thus, to go from Puerto Iguazu to Ciudad del Este it is necessary to pass through Foz do Iguaçu, or use an alternate route across the river by boat.

The recent demise of the Argentine Peso and inflation of the Brazilian Real makes Puerto Iguazu somewhat more popular destination for price sensitive tourists, although Arab businesses do not seem to grow with the same vigor as in the other two neighboring TBA cities, perhaps due to the unfavorable attention Arabs have received since the bombings in Buenos Aires in the 1990s.¹¹² In 2006, it was reported that the Argentine city of Misiones, which is located near the Paraguayan border and south of Puerto Iguazú, had become a “new base on the smuggling route for drugs obtained in Paraguay due to its convenient location.”¹¹³ As a result, criminals use the area “to exchange cocaine for weapons,” which are often “destined for paramilitary groups,” possibly even for Revolutionary Armed Forces of Colombia (FARC) members based in Paraguay and Brazil.¹¹⁴



Figure 12. The TBA's Geography

¹¹² Hudson, *Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America*.

¹¹³ BBC Monitoring Latin America, “Misiones in Argentina reportedly new base for Paraguay-Brazil drug trade,” September 6, 2006, accessed September 14, 2011, <http://www.lexisnexis.com>.

¹¹⁴ Ibid.

In 1970, a deal was struck between Paraguay and Brazil to construct the Itaipu hydroelectric plant on the Parana River, which was the greatest single factor in transforming the region into the trade hub it is today. During the period of Itaipu's construction the towns of Foz do Iguacu and Ciudad del Este flourished, as new businesses sprung up to accommodate workers and immigrants. A particularly large increase in Palestinian and Lebanese immigrants escaping persecution from the Arab-Israeli Wars flowed into the area during the 1970s and 1980s. These immigrants added to a pre-existing first wave of Palestinians that arrived during the collapse of the Ottoman Empire at the turn of the century. The TBA is now home to the second largest Arab Diaspora in South America, second only to Sao Paulo's.¹¹⁵

After the primer of hydroelectric power, the region experienced unprecedented growth and by 1990 the new democratic governments in Brazil, Argentina, and Paraguay sought to increase revenues from tourism by capitalizing on the beauty of the Iguacu Falls and also the promotion of foreign direct investment. In order to facilitate tourism and commercial growth, all the three nations established duty-free areas on their respective sides of the border. Thus, the lure of duty free imports, little government intervention, and the opportunity to supply goods and services to the Brazilian and Argentine markets added to the tremendous growth of Ciudad del Este and its SEZ in the 1990s. In 2002, Argentina established ZFPI (Zona Franca Puerto Iguazu) across the river.¹¹⁶ However, this chapter's discussion of an SEZ in the TBA will concentrate on Ciudad del Este's free zone status, which will generically be referred to as the TBA.

B. SECURITY ISSUES

Lax regulation in the TBA provides organized crime with the salient marketplace to move illicit goods and services. Corruption and lack of state controls provide the additional ability to launder money behind weak banking regulations, primarily in Paraguay. Additionally, organized crime usually follows patterns of ethnic migration.

¹¹⁵ Hudson, *Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America*, 10.

¹¹⁶ Richard H. Friman and Peter Andreas, *The Illicit Global Economy and State Power* (Lanham, MD: Rowman & Littlefield Publishers, 1999), 87.

For instance, the Italian mafia is pervasive in Chicago and the Russian mafia in New York, where strong ethnic Italian and Russian immigrant populations reside. In this same manner, Arab, Lebanese, Chechen, and Chinese mafias have latched onto the immigrant populations found in the TBA. Ethnic ties and shared ideology provide organized crime with a means to mitigate risks by allowing them to deal with individuals that are deemed more trustworthy (their own ethnicities) and to develop reliable networks to smuggle drugs, weapons, and people more freely across borders.

Additionally, the incredible violence in the TBA shows organized crime's pervasiveness in everyday life. In 2009 alone, Foz do Iguaçu with some 300,000 inhabitants surpassed one of the United States' most dangerous cities, Detroit Metro with 900,000 inhabitants, registering 386¹¹⁷ homicides as compared to 379¹¹⁸ in Detroit. Even more stunning is that these figures do not take into account neighboring Ciudad del Este, likely a more violent city than Foz do Iguaçu, because of its unpublished homicide figures.

Moreover, the TBA is also associated with terrorist activity. The bombings of the Israeli Embassy in 1992 that killed 29 people and Jewish Community Center in Buenos Aires in 1994 that killed 85 people are both linked to Islamic terrorist cells coming from the TBA¹¹⁹. Reportedly the late Hezbollah operative, Imad Mughniyah entered Argentina through the TBA to coordinate the attack.¹²⁰ Since the 2001 attack on the World Trade center in New York, several individuals have been arrested in the TBA for

¹¹⁷ "Homicide Rate Declines in Foz do Iguaçu," *A Gazeta do Iguaçu*, June 5, 2009.

¹¹⁸ Charlie LeDuff and Santiago Esparza, "Detroit police routinely under-report homicides Actual '08 total gives city worst rate in nation," *detnews.com*, accessed June 18, 2009, <http://www.detnews.com/article/20090618/METRO/906180406/1409/METRO/Detroit-police-routinely-underreport-homicides>.

¹¹⁹ Hudson, *Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America*.

¹²⁰ Unclassified Report provided by DEA Unit, USDAO Paraguay.

financing terrorist groups like Hamas and Hezbollah. A couple of the most notable arrests include Assad Ahmad Barakat in 2002¹²¹ and Moussa Ali Hamdan in June 2010.¹²²

The TBA is a known hub for arms and drug trafficking, document and currency fraud, money laundering, and the proliferation of pirated goods. For example, it is estimated that 6 billion cigarettes are smuggled through the TBA each year, representing 900 million dollars' worth of lost potential Paraguayan tax revenue,¹²³ of which a large percentage is believed to help finance transnational organized crime and terrorist organizations. International pressure in the TBA since the 1994 attack in Buenos Aires has forced some illicit businesses to move. However, with an entrenched permissive environment for criminal activity and links to transnational terrorism, curbing this nexus in the TBA still remains a serious security issue.

C. THE ACTORS

1. Political/Economic Actors

The TBA's economy is estimated at about \$10 billion.¹²⁴ Pinpointing an exact figure is difficult because of its prevalent cash market, vast informal sector, and ubiquitous smuggling operations. Paraguay's informal economy, largely centered on Ciudad del Este, is estimated to be about 75% of its total GDP, which is rather large when juxtaposed against its neighbors Argentina and Brazil, whose informal sectors are estimated to be at 20% and 25% of GDP, respectively. As a result, a vast majority of goods traversing the TBA are not captured by the formal economy and are difficult to quantify. The TBA is also considered to be the third largest cash retail market in the world behind only Hong Kong and Miami.¹²⁵ Although Ciudad del Este can boast about

¹²¹ Hudson, *Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America*, 29.

¹²² Ecurra, "Moussa Ali Hamdan, as suspected Hezbollah financier, arrested in Paraguay."

¹²³ Alejandro Ramos. "Illegal trade in tobacco in MERCOSUR countries," *CIET Uruguay*, June 2009.

¹²⁴ About 60% of Paraguay's GDP. Estimate from CIA World Factbook.

¹²⁵ Hudson, *Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America*.

its placement in the world rankings as a retail economy, a clearer understanding of the political actors evolve when looking at the Paraguayan economy as it relates to its “big brother” Brazil.

Paraguay is one of the poorest countries in Latin America and although a recent bumper crop of soybeans and livestock in 2010 relieved the situation, the economy continues to be susceptible to drought and the global economic downturn. Unlike Panama, Paraguay does not have a diversified service sector or financial sector to lean on in times when commodity export demands are low or the production of main commodities slows down. Despite a fairly large service sector tied up mostly in the sale of hydroelectricity and the retail market in the TBA, Paraguay’s economy is in fact largely agrarian, with main exports comprising of soybeans, meats, and other agricultural products.

These exports are chiefly destined for Brazil and Argentina due to a lack of access to the Atlantic Ocean and international markets. In fact, Ciudad del Este and its SEZ were meant to be a way to mitigate the lack of ocean access by offering a place to package and ship materials abroad, yet the primary focus still remains the transportation of cheap goods to its immediate neighbors. Paraguay’s port authority actually manages free trade ports and warehouses in neighboring countries’ seaports. These seaports are used for the reception, storage, handling, and transshipment of merchandise transported to and from Paraguay. Such free trade ports are located in “Argentina (Buenos Aires and Rosario); Brazil (Paranagua, Santos, and Rio Grande do Sul); Chile (Antofagasta and Mejillones); and Uruguay (Montevideo and Nueva Palmira). About three-fourths of all goods entering and exiting Paraguay are transported by barge on the large river system that connects ports in Ciudad del Este and Asuncion with Buenos Aires (Argentina) and Montevideo (Uruguay).”¹²⁶ Despite the legal trade, Paraguay is also known for its

¹²⁶ U.S. State Department, *Money Laundering and Financial Crimes Country Database, Volume I*, 278.

“illicit” economy and as a transit country for Andean cocaine, cheap pirated goods, and homegrown marijuana. Indeed, Paraguay is the largest producer of Marijuana in South America.¹²⁷

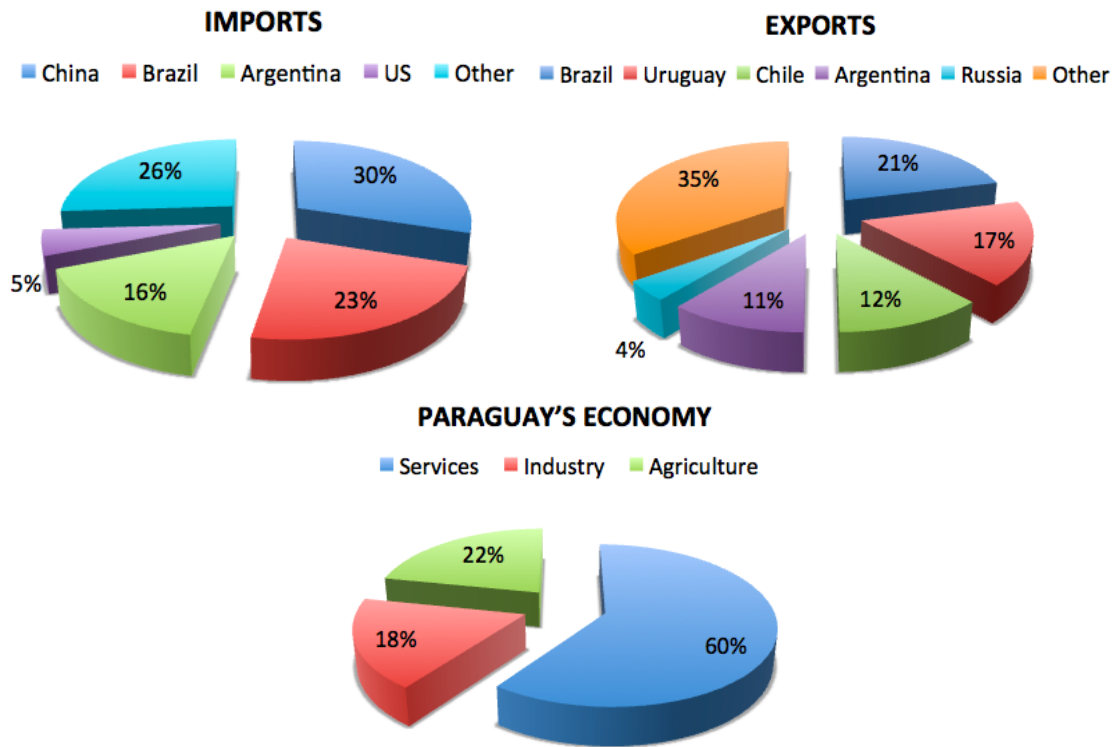


Figure 13. Paraguay's Economy¹²⁸

Not surprisingly, the economies of Ciudad del Este, Foz do Iguaçu, and Puerto Iguazú are heavily intertwined due to their geographic proximity. “Some 30,000 people cross the Puente de la Amistad from Brazil to buy tax-free and sell for a profit in highly taxed Brazil and Argentina.”¹²⁹ Many independent entrepreneurs called “sacoleiros” in Brazil or “passeros” in Argentina engage in these practices every day.¹³⁰ Additionally,

¹²⁷ June S. Beittel, *Paraguay: Political and Economic Conditions and U.S. Relation* (Washington: Congressional Research Service, February 1, 2010).

¹²⁸ Data derived from CIA World Factbook.

¹²⁹ Aguiar, “Stretching the Border: Smuggling practices and the Control of Illegality in South America.”

¹³⁰ *Ibid.*, 15.

there are a large majority of Brazilians that reside in Paraguay. It is estimated that 500,000 (about 10% of the Paraguayan population), are so-called “brasiguayos,” Brazilians that have obtained Paraguayan citizenship and reside either legally or illegally in Paraguay.¹³¹ The impact of the brasiguayos to the political economy of the TBA is significant.

Paraguayans, especially farmers and cattle ranchers in the Alto Parana (vicinity of the TBA), often describe the brasiguayos as a threat to national sovereignty. “The brasiguayos are considered by many as elements of Brazilian expansion policy.”¹³² Thus, Paraguay-Brazil diplomatic relations often suffer from an undercurrent fear or paranoia of Brazilian expansionism. This fear dates back to Paraguay’s independence, but is also tied to Brazil’s well-published “Golberry doctrine,” the national security measures that Golberry, Brazilian Army Chief during the dictatorship years, instituted. In it, Golberry clearly identified Brazil’s national security in terms of state expansion and state-led economic growth, which still worries the Paraguayans to this day. Adding to this is the fact that the Brazilian currency (Reals) is the currency of choice in Ciudad del Este rather than the Paraguayan one (Guarani). Guaraní’s are often not even accepted by banks on the Brazilian side of the TBA just across the bridge. Thus, although the brasiguayos are no doubt an important part of the Paraguayan economy and becoming a larger part of the political scene in Paraguay, pretensions and concerns over national sovereignty in the TBA still abound and are a part of Paraguayan politics today.

Brazil’s relative size compared to Paraguay and its enormous industrial base means it is a large consumer of Paraguayan goods. One of these goods, and perhaps most important to the political framework of the TBA, is the electrical consumption of Itapú’s dam. Not surprisingly, most of Itaipu’s electricity, approximately ninety percent of the electricity produced,¹³³ is consumed by Brazil. Consequently, Paraguay is able to sell their share of the electricity generated from Itaipu to Brazil (although at an arguably

¹³¹ Carvalho, “El Portentoso Alto Parana,” 113.

¹³² Ibid., 114.

¹³³ BBC News, “Why Brazil gave way on Itaipu dam,” July 26, 2009, accessed May 11, 2011, <http://news.bbc.co.uk/2/hi/8169139.stm>.

unfavorable price). The sale of electricity makes the cost of electricity relatively lower in Ciudad del Este, which affords a major comparative advantage for businesses seeking to establish themselves on the Paraguayan side of the border. Yet despite this, very few large multinational corporations reside in the TBA.

Small shops and businesses that take advantage of tax breaks on the Paraguayan side of the river dominate Ciudad del Este's economy and not large multinationals that seek cheap electricity to produce goods. The true economic success of Ciudad del Este depends primarily on the efficient transfer of goods and services to Foz do Iguaçu, as evidenced from the large number of small shipping and freight companies established in the TBA. Like Colon in Panama, the TBA is mostly an entrepot for the repackaging and re-exportation of goods and survives largely as a tax haven. Additionally, the development of the Common Market of the South (Mercosur) free trade bloc, has made the borders between Paraguay, Brazil, and Argentina more open and made it easier for citizens to obtain resident visas and for businesses to move containers transiting from Paraguay to other Mercosur countries.¹³⁴

The TBA is also heavily dependent on its Lebanese and Chinese businessmen, creating a situation in which the Paraguayan government is reluctant to alienate them by engaging in policies that would hamper their economic prosperity.¹³⁵ The crackdowns and pressure since September 11 has negatively affected the Arab community in the TBA, primarily across the Brazilian border in Foz do Iguaçu. The area has roughly a population of 30,000 Arabs,¹³⁶ most of which are prosperous Lebanese immigrants with political influence. Arabs in the TBA also have their own Arabic-language cable channel, mosques, and country clubs. Most of the Arabs in the TBA also practice the Shia form of Islam. The TBA surprisingly has a total of 6 mosques, rare for area within two largely Catholic nations. Much of the Arab community in Foz do Iguaçu is closely related to the Arab community of Ciudad del Este, which adds to the already strong

¹³⁴ BBC News, "Why Brazil gave way on Itaipu dam."

¹³⁵ Aguiar, "Stretching the Border: Smuggling practices and the Control of Illegality in South America."

¹³⁶ Unclassified report provided by DEA Unit, USDAO Paraguay.

commercial ties between the cities. Furthermore, evidence shows many prosperous Arabs have purchased land on both sides of the Paraguay-Brazil border directly across the river, raising some concerns of foul play.

Another important topic to the political economy of the TBA is the dynamic of the current ruling party in Paraguay and its effect on the government policies. The country is currently under a democratically elected leftist government headed by President Fernando Lugo. This is especially significant in a country that was ruled for the previous 62 years by the Colorado Party (the political right) and military dictatorship. Many of the government officials, military, and police in the TBA held their breath as the new regime took over in 2008, fearing things would drastically change. Although President Lugo vowed to fight corruption as one of his campaign promises there has not been a significant decline in the level of corruption or to the clientelist way the government operates. Lugo has certainly done his part by firing wave after wave of high-ranking military officers with claims of corruption, but these tactics are also considered more of a political necessity to keep the military (and supporters of the Colorado party) in check than a real corruption purge. Paraguay is still considered the 2nd most corrupt country in the western hemisphere, behind only Venezuela and more corrupt than Haiti.¹³⁷

In fact, President Lugo himself, members of his own cabinet, and members of his family are implicated in corruption and scandals. In April 2009, for instance, the President was accused of fathering children during his years as a priest with three different women, of which he has admitted to fathering one. This scandal has further undermined his credibility and effectiveness to run the government especially in the face of a divided congress and severe Colorado party opposition.¹³⁸ President Lugo's socialist agenda is frequently accused of having ties to the socialist agenda of the EPP (Paraguayan People's Army), a terrorist group in Paraguay that sympathizes with the FARC, although this is largely uncorroborated. Interestingly, Lugo has stated that terror

¹³⁷ Transparency International, "Corruption Perceptions Index 2010," accessed May 12, 2011, http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results.

¹³⁸ Economist Intelligence Unit, *Country Report: Paraguay*, December 2009.

financing in the TBA is a myth, despite the cases brought forth since 2001. He is believed to sympathize with Venezuela's president Hugo Chavez although members of the congress increasingly put pressure on him to distance himself from Chavez and the "Bolivarian" movement. In fact, Paraguay's negative stance in the Mercosur parliament is basically the sole reason that Venezuela is not a current member of the regional trading block. At times Paraguay is severely polarized as evidenced when on December 5, 2010, when delegates of the 600-strong Paraguayan congress voted to discuss the possibility of supporting impeachment proceedings of President Lugo.¹³⁹ Despite all of the turmoil, President Lugo is believed to complete the rest of his term until the next election in 2013.

Politics in Paraguay is a very personal one based more on who you know than what you know. Under President Lugo's new regime this hasn't changed one bit. In the TBA, as in all of Paraguay, market values and old clientelist values are still clashing. These hierarchical communities, where patrons such as lords or dons receive gifts from clients as expressions of loyalty in exchange for life-long protection, clash with the development of market-based institutions such as customs, immigration and law enforcement, which can potentially lead to violence.¹⁴⁰ Developing countries like Paraguay tend to have political cultures characterized by "intergroup conflict (deep in-group/out-group feelings), less respect for individual freedom, stronger religious beliefs, greater respect for loyalty and hierarchy than for rule of law, and extensive informal patronage networks (known for, among other things, high levels of corruption)."¹⁴¹ The political and economic actors in the TBA are immersed in this "culture" as evidenced by Transparency International's 2010 ranking of Paraguay as 146th out of 178 countries on their annual global corruption perceptions index.¹⁴²

¹³⁹ Economist Intelligence Unit, *Country Report: Paraguay*, 11.

¹⁴⁰ Ibid., 10.

¹⁴¹ Michael Mousseau, "Market Prosperity, Democratic Consolidation, and Democratic Peace," *The Journal of Conflict Resolution* 44, no. 4 (August 2000): 472-507, accessed October 26, 2010, <http://www.jstor.org/stable/174638>.

¹⁴² Transparency International, "Corruption Perceptions Index 2010."

2. Illicit Actors

The informal economy of the TBA is dominated by the illegal activities of smuggling, violating intellectual property, money laundering, and terror financing. Illicit actors that thrive in the TBA include, but are not limited to: Hezbollah, Hamas, Al Qaeda, the Brazilian mafia, Chinese mafia, the Lebanese mafia, Chechen mafia and the FARC.¹⁴³ Although the overall dimensions of organized crime in the TBA are difficult to fully quantify, the pervasive environment has produced several noteworthy cases.

Smuggling is an issue in the TBA that is magnified by its proximity and shared border with Brazil, Argentina and Bolivia. Augmenting this is the fact that barely 100 Paraguayan military men are in charge of covering and securing the porous borders between Bolivia and Paraguay.¹⁴⁴ Also, Paraguay has a rich tradition of smuggling through its borders by its neighbors. In the 1960s and 1970s, for instance, Paraguay did not produce coffee but appeared as one of the world's largest exporters of coffee.¹⁴⁵ Presumably, the coffee exported came from Brazilian and Colombian companies that chose Paraguay as the entrepot to get their products to market and avoid native export tariffs. Most goods that are smuggled today are still goods that are obtained cheaply in Paraguay and then smuggled across the border to evade high import and export tariffs. Reportedly, numerous unidentified aircraft arrive in Ciudad del Este and in Asuncion international airport and are quickly unloaded for distribution and repackaging in the TBA. Most goods are fake electronics and clothing from China, but there also loads of weapons, cash, and other illicit merchandise moving through this SEZ. The smuggled goods are helped along the way by bribes and pay-offs of customs officials, airport security, and whomever else can potentially get in the way. The level of corruption involved in the smuggling operations in Paraguay is believed to run all the way to the top tiers of government. A recent Paraguayan newspaper reported, "On November 16, 2010,

¹⁴³ Cyrus Miryekt, "Hezbollah in the Tri-State Border Area of South America," *Small Wars Journal*, 6.

¹⁴⁴ La Nacion, "Apenas 100 Militares cubren la linea de frontera con Bolivia," June 11, 2009.

¹⁴⁵ Pablo Dreyfus, "Investicacion del Proyecto Control de Armas de Fuego, Viva Rio/ISER," *Agenda de Seguridad en el MERCOSUR: Triple Frontera como espacio de inseguridad regional*, Rio de Janeiro, 2005, 4.

4 Ak-47s and an M-16 were found among a shipment of auto parts by customs officials. In the proceedings, the prosecutor Nicasio Galeano identified the owner of the merchandise as Maria Fernanda Lugo,”¹⁴⁶ a close relative of the current President of Paraguay.

Another instance of weapons smuggling involved Argentine ammunition that was smuggled through Puerto Iguazu and then into Ciudad del Este through the Friendship Bridge by the use of a “passero.” The boxes of bullets were destined for containers in the SEZ of Ciudad del Este for packaging and shipment and also to shops in the various duty free areas where they could be purchased at wholesale prices. When the passero was questioned about the boxes, he stated, “I always agree to deliver merchandise in closed boxes with complete confidence. I never question or ask names because they give me work and a job, so I always accept.”¹⁴⁷ Despite the legality of some arms trade, the permissive environment in the TBA also allows ‘legal’ arms to in turn become illegal. “Ammunition produced in Mexico are legally exported and then illegally triangulated in Paraguay and Brazil. The same goes for small arms produced in Argentina and Brazil, which also end up being smuggled into Colombia where either paramilitary or guerrilla groups use them. Globalization is a phenomenon that certainly has its dark side.”¹⁴⁸

There are all types of illicit activities involved with the arms trade through Ciudad del Este. For example, a recent report by the Paraguayan press described a trafficking ring that used stolen cars to finance weapons sales. Cars stolen in Sao Paulo are transferred to Ciudad del Este and sold in the black market or traded for weapons.¹⁴⁹ Reportedly, Paraguayan police were paid \$200 for each of the cars allowed to enter Ciudad del Este.

Drugs are one of the most sought after products in the emerging Brazilian economy. Brazilian demand makes Paraguay a natural transshipment point for cocaine and marijuana. It is estimated 40–60 tons of cocaine will pass through Paraguay in

¹⁴⁶ ABC, “Detectan supesta red de trafico de armas tras decomiso en aeropuerto,” April 15, 2011, 48.

¹⁴⁷ La Nacion, “Balas incautadas revelan fragil control en Puente de la Amistad,” May 4, 2011, 42.

¹⁴⁸ Dreyfus, “Investicacion del Proyecto Control de Armas de Fuego, Viva Rio/ISER,” 4.

¹⁴⁹ Ultima Hora, “Coches robados canjean por armas en Paraguay,” December 14, 2010.

2011.¹⁵⁰ It is also estimated that 80% of the cocaine smuggled into Brazil comes from Paraguay.¹⁵¹ In fact, the largest cocaine bust in Paraguay's history occurred just recently on June 1, 2011. As Paraguay wrapped up its Independence Bi-Centennial celebrations, 860 kilos of cocaine were seized hidden in bags of rice headed for Mozambique and on to European markets. Special trained units working in conjunction with U.S. DEA instead of counter-narcotics units of the Paraguayan police, perhaps to avoid corruption and tampering carried out the sting operation. "The containers were loaded with rice in Ciudad del Este and from there were brought to Puerto Fenix for transshipment."¹⁵² The weight of the cargo was suspicious and despite the claims that it was rice headed to deprived country, DEA agents were quick to realize this was anything but a legitimate shipment.

A particularly worrisome issue in the TBA is the nexus between drug traffickers, criminal organizations, and terrorist groups. Groups like the Paraguayan EPP, the Brazilian PCC (Primer Commando Capital) and the CV (Commando Vermelho), all anti-establishment groups with deep ties to the drug trade, conduct their business along the porous Brazil-Paraguay border and also in the TBA where they can easily co-opt Paraguayan officials. Links between the EPP and the FARC (themselves narco-traffickers) were conclusively reached when Manuel Olate Cespedes was supposedly put in charge of a force that was to link the two groups together with the FPMR (Frente Patriótico Manuel Rodríguez), the official armed faction of the Chilean Communist Party. According to manuscripts discovered in an investigation after FARC leader Raul Reyes was killed, Manuel Cespedes and the FARC were coordinating efforts to merge all three communist guerilla groups into a larger South American Guerilla Army.¹⁵³

¹⁵⁰ Ultima Hora, "Estiman que de 40 a 60 toneladas de cocaine pasan por Paraguay," March 3, 2011, 1.

¹⁵¹ Ultima Hora, "Paraguay es la official oficina del PCC y Comando Vermelho," May 18, 2011, 48.

¹⁵² Ultima Hora, "Antidrogas Capturan la Mayor Carga de Cocaina de Historia," June 1, 2011, 49.

¹⁵³ ABC, "Surgen nexus de extremist chileno con 'commandantes' del FARC y EPP," March 10, 2011, 38.

The PCC (Sao Paolo based) and the CV (Rio de Janeiro based) organized crime groups are perhaps the most notorious criminal organizations involved with the drug trade through the TBA, but there are certainly others. “The President of the Brazilian Federal Police in Asuncion questions the police corruption that favors the installation of these mafia groups. He says that it is cheaper for Brazil to fight the marijuana trade here on Paraguayan territory.”¹⁵⁴ The PCC and the CV are groups of criminals who settled in Brazil and Paraguay and established partnerships with local criminals to eliminate middlemen in drug and weapons trafficking. The President of the Brazilian Police says, “the PCC operates as if they were a shipping company, with an office in Sao Paolo and distribution center is here (Paraguay).”¹⁵⁵

Money laundering is equally a concern in the TBA as in Colon. Ciudad del Este has approximately 55 different banks and foreign exchange shops, most of which go unregulated.¹⁵⁶ The United States estimates that \$6 billion a year in illegal funds are laundered there, an amount equivalent to 50 percent of the official gross domestic product of Paraguay.¹⁵⁷ There is also evidence to suggest that a large sum of the earnings from illegal activities goes in support of the Lebanese terror organizations in the form of “Hawala,” a money transfer system which uses no financial institutions, or by charitable foundations and front institutions. Dionisio Borda the Paraguayan Minister of Finance admitted, “it is important to note that in border cities it is a common practice to launder money in exchange houses ‘mau,’ firms that subsequently deposit the cash in a bank account across the border, especially in Punta Pora and Foz do Iguacu.”¹⁵⁸ Additionally, there are no official statistics on the inflow and outflow of foreign exchange to the country, making it even more difficult to track money laundering.

¹⁵⁴ Ultima Hora, “El Presidente de la Policia federal brasilena en Asuncion cuestiona la corrupcion policial que favorece la instalacion de los grupos mafiosos,” May 11, 2011, 48.

¹⁵⁵ Ibid., 48.

¹⁵⁶ Abbott, “Terrorist Threat in the Tri-Border Area: Myth or Reality?.”

¹⁵⁷ Ibid., 51.

¹⁵⁸ La Nacion, “Commercio en ciudades fronterizas,” March 5, 2010, 38.

A testament to this are numerous private aircraft parked in the Ciudad del Este airport that receive cash from “Prosegur” armored vehicles, a privately owned security service, and then fly the cash out of the country with wreck less abandon.¹⁵⁹ Under invoicing and false invoicing of materials destined for Ciudad del Este is yet another method illicit actors use to launder money. Recent cases show that containers entering Ciudad del Este were found to have false registry where the shipment of electronics was actually discovered to be a cargo full of cement blocks.¹⁶⁰ An investigation in 2006 involving HSI special agents and CBP officers, along with JTTF (Joint Terrorism Task Force) members, “determined several Miami based freight forwarding companies were illegally exporting electronic goods to Galeria Page. Working with TTU partners in Paraguay to verify paperwork, agents discovered the criminals concealed the true destination of the prohibited shipments by using fake invoices containing false addresses and fictitious ultimate consignees on required export paperwork. Additionally, wire transfer payments were routed through various facilities to mask their true origin.”¹⁶¹

Moreover, transnational criminal organizations in the TBA have been linked with transnational Islamic terrorist groups. Organized crime networks linked to terror networks are believed to levy a “war tax” on businessmen to finance their ideological causes. For instance in 2002, Armando Kassen, a Lebanese citizen who was president of the Paraguayan Arab Chamber of Commerce, fled to Beirut after being convicted of murdering a Ciudad del Este businessman, Ussein Mohamed Taiyen, who reportedly refused to pay the “war tax”.¹⁶² Another instance of violence, this time on a transnational scale, involved the murder of Uruguayan Customs Director Víctor Lissidini who was shot by four armed gunmen on motorcycles in Montevideo, in reprisal for the confiscation of a batch of counterfeit merchandise bound for Ciudad del Este in 2003.¹⁶³

¹⁵⁹ Office of International Affairs, “Paraguay Tri Border Assessment,” *U.S. Customs and Border Protection*, May 2010, 9.

¹⁶⁰ *Ibid.*, 34.

¹⁶¹ U.S. Immigration and Customs Enforcement, “Homeland Security Investigations Trade,” *The Cornertstone Report*, vol. VII, no. 3, Winter 2011, 8.

¹⁶² Hudson, *Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America*, 36.

¹⁶³ *Ibid.*, 37.

The lax political and economic environment that was created by political actors has allowed the growth of several important Arab mafia “families” in the TBA, which have suspected connections with the Lebanese Hezbollah. Perhaps one of the most notorious of these “families” is the Barakat family, who were turning the profits made through drug trafficking and illicit pirated goods to transfer large sums of money to bank accounts in the Middle East with connections to Hezbollah. Businessmen connected to the Barakats had a great deal of political influence in the TBA, which allowed the Barakats to take advantage of a network of corrupt officials, to include Paraguayan judges, prosecutors, intelligence services, security forces as well as some journalists.¹⁶⁴ As a result, Assad Ahmad Barakat was designated a Specially Designated Global Terrorist (SDGT) by the U.S. State Department in 2004.¹⁶⁵ Some of the illicit actors who were officially identified by the U.S. government and have been arrested in connection with the Barakat family are shown in Table 1.

¹⁶⁴ Aguiar, “Stretching the Border: Smuggling practices and the Control of Illegality in South America.”

¹⁶⁵ U.S. Embassy Paraguay, “Hizballah Fundraising Network in the Triple Frontier,” accessed June 13, 2010, http://paraguay.usembassy.gov/hizballah_fundraising_network_in_the_triple_frontier2.html.

Name	Position	Links	Other Info
Muhammad Yusif Abdallah	Senior Hezbollah Official	Managed Galeria Page Passed out false documentation Served as courier of funds Contraband electronics and narco-trafficking	NA
Hamzi Ahmad Barakat	Hezbollah Leader	Managed Casa Hamze and a store in Galeria Page Narcotics and arms trafficking Counterfeit U.S. Dollars Contraband electronics	NA
Hatim Ahmad Barakat	Manages funds Oversee transactions from Iquique SEZ in Chile	Business relationships with other Hezbollah members Contraband electronics Co-owned Casa Apollo with brothers	NA
Muhammad Fayeze Barakat	Hezbollah (Barakat Clan Finance Minister)	Money Transfers via Hawala and other means to Middle East Hosted a variety of fundraising events in the TBA	NA
Muhammad Tarabian Chamas	Hezbollah Counterintelligence Officer	Provided security information on residents of TBA, Private Secretary for Muhammad Yusif Addallah, transported funds to Iran and Lebanon via hawala Collected money	NA
Saleh Mahmoud Fayad	Hezbollah Counterintelligence Officer	Collected money	NA
Sobhi Mahmoud Fayad	Senior Hezbollah Official	Served as liason between Iranian embassy and Hezbollah in TBA, drug trafficking, counterfeit U.S. Dollars, Assad Ahmad Barakat's Executive Assistant, money transfers to Hezbollah charity in Lebanon	Sentenced to 6.5 years in Paraguay for tax evasion
Ali Muhammad Kazan	Succesor to Assad Ahmad Barakat as the leader of Hezbollah in TBA	Since 2006, helped raise \$500,000 for Hezbollah from Lebanese businessmen in TBA	NA
Farouk Omairi		Assisted Lebanese citizens with false Brazilian and Paraguayan documentation, Narco-trafficking	Captured in Foz do Iguacu in 2007

Table 1. The Barakat Network¹⁶⁶

Although many of the members of the Bakarat family were arrested, deported, or are in hiding, others like Moussa Ali Hamdan, recently arrested in the summer of 2010 in

¹⁶⁶ Data obtained from U.S. Embassy Paraguay, "Hizballah Fundraising Network in the Triple Frontier;" and Horacio Calderon, *Organized Crime and terrorism in the Tri State Border Area*, Specialist in Counterterrorism: horaciocalderon.com, Buenos Aires, 2007, 2.

Foz do Iguacu are still being discovered. The Hezbollah network in the TBA is reportedly deeply tied to many Lebanese commercial businesses that pay a percentage of their incomes (Islamic Zaqat) to Hezbollah.

Other criminal organizations in the TBA with regional and global reach, like the Colombian, Brazilian, Chinese, and Russian mafias also share several common linkages with terrorist groups and conceal and transfer illegal profit from drug trafficking, fundraising, kidnappings, contraband smuggling, extortions, and money laundering to these groups. The combination of economic infrastructure and profit potential is a successful recipe for fundraising operations. The existence of a well-developed financial infrastructure and influential businessmen sympathetic to Hezbollah's ideology are force multipliers for the pervasiveness of these issues.

There is also evidence that other terror groups like Al Qaeda are using the TBA to infiltrate the region to conduct operations. In 1999, an Egyptian named El Said Hassan Ali Mohamed Mukhlis who resided in Ciudad del Este, also allegedly tied to Egypt's Al-Gama'a al-Islamiyya, was arrested in Montevideo, Uruguay en route to Europe to link up with a terrorist cell tied to Al Qaeda. In February 2000, Ali Khalil Mehri, a naturalized Paraguayan citizen born in Lebanon who was living in Ciudad del Este was arrested by Paraguayan authorities and charged with selling millions of dollars' worth of counterfeit software and then channeling the proceeds to Al Qaeda. Authorities searching his home found videos of known suicide bombers and propaganda.¹⁶⁷ U.S. officials believe the material's purpose may have been to radicalize Arab youths in Paraguay, Brazil and Argentina. Mehri, then a campaign contributor to powerful members of Paraguay's ruling Colorado Party, escaped from prison and fled to Syria, where he has continued to deny these charges. Paraguayan authorities also arrested Salah Abdul Karim Yassine, a Palestinian who entered the country using false documents. Yassine was allegedly "plotting to bomb the United States and Israeli embassies in Asuncion and was allegedly securing \$100,000 in financing while living in Ciudad del Este."¹⁶⁸

¹⁶⁷ Calderon, *Organized Crime and terrorism in the Tri State Border Area*, 2.

¹⁶⁸ Ibid.

Finally, corrupt political actors are heavily involved and in cooperation with illicit activities in the TBA. It is well known in Paraguay that occupations like police officers, customs officials, or other government positions are not lucrative jobs where fortunes are made; except, that is, if Ciudad del Este is your assignment. The pay-offs are high in Ciudad del Este, which can raise a Police officer's pay from \$300 a month to as much as 6,000 a month.¹⁶⁹ In March 2010, 1000 police were summoned on corruption charges and 300 were sanctioned,¹⁷⁰ many of these coming from the Alto Parana region of Paraguay. In August of 2009, a Ciudad del Este customs official was discovered while running 48 Kilos of ephedrine (a controlled substance in Brazil) through the border with a prominent Brazilian businessman and while holding \$40,000 in U.S. dollars.¹⁷¹ Even more embarrassing to Paraguay was a scandal involving a former Paraguayan military attaché' to the Paraguayan Embassy in Brazil, COL Ausberto Waldimiro Bejarano, when he was stopped by Brazilian officials in a vehicle after crossing the border with controlled substances. According to the Brazilian press, police found about 114,000 Pramil sexual stimulant tablets, 10,000 vials of anabolic steroids, 1,750 vials of diet pills and 1,300 vials of Citotec abortion tablets.¹⁷² Cases such as these continue to demonstrate the rampant problems of corruption and co-opted officials at all tiers of Paraguayan government.

Even when there are arrests, the questionable judiciary and corrupt security officials makes enforcing the rule of law extremely problematic in the TBA. An investigation in May 2011 involving a narco-trafficking ring proves the point. "Three judges, Silvio Reyes, Maria Baez and Enrique Alfonso were let go due to an investigation where they let the son of a well-known narco trafficker go"¹⁷³ despite obvious evidence that he was taking part in the same drug trafficking practices as his father. In February

¹⁶⁹ Office of International Affairs, "Paraguay Tri Border Assessment," 10.

¹⁷⁰ La Nacion, "1000 Policias Sumariados," March 5, 2010, 39.

¹⁷¹ ABC, "Caen un Aduanero Despachante y un Comerciante con supesta Efedrina," August 3, 2009, 48.

¹⁷² ABC Digital, "Detienen a un militar en Brasil con medicamentos ilegales," February 17, 2011.

¹⁷³ La Nacion, "Jurado remueve de sus cargos a los 3 jueces que liberaron a hijo de Pavao," May 19, 2011, 65.

2011, 5 counter narcotic agents were condoned for keeping 900 kilos of Marijuana for themselves.¹⁷⁴ These are all recent cases, and the Paraguayan newspapers are full of stories like these every single day.

3. Security Actors

Despite the pervasive issues of crime and terror financing in the TBA, the situation has not gone unchecked, as numerous efforts by security actors like the Brazilian government, the Argentine intelligence service, the Paraguayan state have contributed to a slightly improved state of affairs in the last decade. Regulations and laws passed by all three countries have influenced some although the effects are still difficult to measure. For instance, in 2004 Brazil passed a series of tax reforms to implement a nation-wide VAT to streamline federal revenues and clean up tax holes created by several regions (the Parana region of the TBA being one of them).¹⁷⁵ However, what appeared on the outside to be more transparent tax laws that would capture more of the informal economy in Foz do Iguaçu, was actually just another protectionist method for the Brazilian government to raise the price of imports as compared to domestic products. The large VAT in effect created an even more desirable situation for illegal smuggling to occur in order to escape taxes, especially through the TBA.

In 2010, the Brazilian Congress authorized the use of military forces in Foz do Iguaçu as well as other regions along the porous borders with Paraguay for matters of national security when local police forces are deemed inadequate.¹⁷⁶ This strategy follows the same line of thinking the Brazilian government uses to clean up the favelas (slums) in Rio de Janeiro for the upcoming 2014 World Cup and 2016 Olympic Games. Although these tactics have worked peacefully and effectively so far in the favelas immediately surrounding the tourist areas of Copacabana and Ipanema, larger favelas

¹⁷⁴ Ultima Hora, “Condenan a 5 agentes por quedarse con marihuana,” February 25, 2011.

¹⁷⁵ Rubens Branco da Silva, *Brazilian tax: Reform and its Impact* (Rio de Janeiro: Branco Consultores, 2004).

¹⁷⁶ June S. Beittel, “Brazilian Army can now intervene in Ciudad del Este and Three-Border Area,” *UNACE*, accessed September 14, 2010, <http://www.TheAmericasPost.com>.

where the drug lords hold a monopoly, like the favela of Rosinha, have yet to be pacified by police and military action. Whether or not these hardline tactics will translate effectively to Foz do Iguaçu remains to be seen. The move by the Brazilian military has also stirred up resentment on the Paraguayan side of the border making some Paraguayan officials question Brazil's real motives.

In 2009 Paraguay instituted its first laws against money laundering, however, with only 200 prosecutors nationwide¹⁷⁷ for a population of 5.5 million in Paraguay, it leaves nearly all money-laundering investigations in Paraguay in the hands of only a few prosecutors. In 2009 the Brazilian government passed the “sacoleiro” law, which formally made the importation of goods from Paraguay legal, but limited the amount an individual could bring into Brazil to an amount worth \$150 USD.¹⁷⁸ In the years before Brazilian citizens were allowed to import up to US\$300 every month. This is a concerted effort by the Brazilian government to formalize the economy in the TBA, at least from their perspective. However, the effects of these new laws are still too recent to realize and signs show no real slowing of the TBAs illicit smuggling economy. The 2010 U.S. State Department's International Narcotics Control Strategy Report summarizes Paraguay's efforts best, “Paraguay's National Anti-Drug Secretariat (SENAD) increased its seizures of cocaine compared to 2008, however the culture of corruption and impunity remains a significant barrier in the battle against organized crime and drug trafficking.”¹⁷⁹

The governments of Brazil, Paraguay and Argentina established a regional intelligence center with headquarters in Foz do Iguaçu in 2006,¹⁸⁰ merging intelligence agencies from the three countries and establishing a shared means of information gathering. Additionally, the three nations also agreed to implement joint patrols of the Itaipu Lake and adjacent waterways and continue work on integrated immigration and

¹⁷⁷ Hudson, *Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America*, 66.

¹⁷⁸ Aguiar, “Stretching the Border: Smuggling practices and the Control of Illegality in South America,” 15.

¹⁷⁹ U.S. Department of State, *International Narcotics Strategy Report Volume 1*, 505.

¹⁸⁰ Hudson, *Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America*.

border control. In June 2009, Brazil donated 3 T-27 Tucano aircraft to the Paraguayan Air Forces as a signal of bilateral cooperation in the fight against illicit activities on their shared border.¹⁸¹ The donation was approved by the Mercosur parliament and was one of the first in cooperative measures to combat drug and weapon trafficking by the Mercosur regional trading block.

The international community, namely the United States and the UK, have taken notice and stepped in to help train police forces in the TBA. Since 2001, U.S. and UK efforts have generally been welcomed with open arms, particularly in Argentina and Paraguay. The UK held numerous bilateral counter-terrorism and counter-narcotics workshops in Paraguay from 2003-2007. In what is part of the 3+1 program established in 1998, (the “+1” representing the United States) the U.S. State Department delivers targeted foreign aid and training resources towards the training of police forces, strengthening of banking practices, border security, and counter narcotics regimes. The U.S. Immigration and Customs Enforcement (ICE) has sent Transparency Team Units (TTUs) to deploy networks and software packages to help detect money laundering schemes in the TBA, practices that actually helped discover Moussa Ali Hamdan as he transferred large sums of cash abroad from off-shore accounts in Paraguay. Other types of programs administered by the U.S. Department of State in Latin America include: an Anti-Terrorism Assistance (ATA) program, an Export Control and Related Border Security (EXBS) program, a Counterterrorism Financing (CTF) program, and a Terrorist Interdiction Program (TIP). The U.S. border patrol has conducted a detailed study of the TBA and border issues and recommends continued support by donating resources and training to Paraguayan customs authorities. A majority of these programs are funded through the Nonproliferation, Anti- terrorism, Demining, and Related Programs (NADR) foreign aid funding account.

In the TBA the illicit actors have penetrated a large section of the overall political economy when compared to an average FTZ or Colon, making the TBA less stable and more dangerous

¹⁸¹ La Nacion, “Brasil donara Aviones Tucanp,” June 24, 2009, 7.

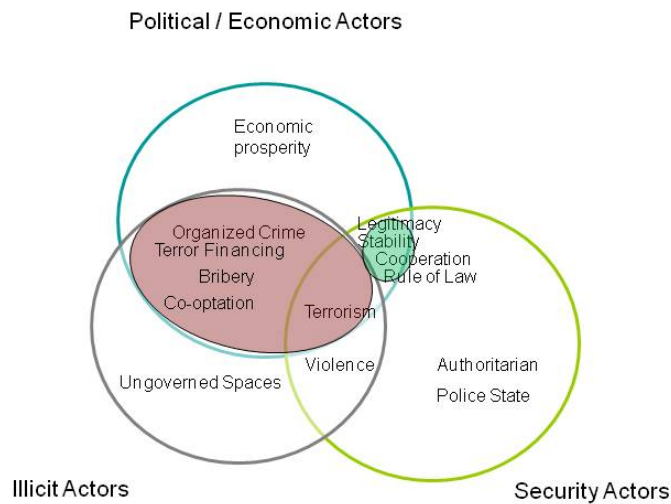


Figure 14. The TBA's SEZ

D. POLICY DETERMINATION

1. Domestic

Given the political dimension of the TBA and its large contribution to the Paraguayan economy, made further complex by its shared border with Brazil and Argentina, it is difficult to recommend any single policy that would satisfy all actors involved. The SEZ in Ciudad del Este, however, is neither transparent nor comprehensible. The Zona Franca Internacional publishes no data on the amount of transactions that takes place within its jurisdiction and is almost certainly not in compliance with WTO standards as it pertains to regulations against government subsidizations and UN conventions on smuggling and terror financing. Moreover, greater Ciudad del Este and its numerous duty free shopping galleries lacks institutional

controls to regulate the commerce taking place, which for all intents and purposes, filters right into Brazil and Argentina with the lack of effective border controls.

The first step in combating organized crime in the TBA is undoubtedly to strengthen the rule of law domestically in Paraguay. The unprecedented amount of violence in the TBA per capita has simply taken away state legitimacy. “The proliferation of non-state violence, a threat to state authority in and of itself, begins to erode civil society as people question the ability of state officials to offer protection, further undermining the authority of the state.”¹⁸² In Ciudad del Este, for instance, the amount of private security out-numbers actual police forces by orders of magnitude. Banks and businesses depend of guns-for-hire to provide protection against well-armed criminals rather than native police forces for fear that corrupt officers will simply steal profits. Adding to the problem, mafia style killings in the TBA have increased as criminals regularly dispose of magistrates, policemen, politicians, civil servants and unionists that interfere with their illicit businesses. Paraguayan police forces in Ciudad del Este in 2003, for instance, numbered a mere 200 officers;¹⁸³ a figure that has not grown by much over the last decade. But it is not simply a numbers game, throwing more police officers at the problem will likely just mean more co-opted policemen, or “polibanda” as the Paraguayans refer to them. Paraguayan police need better equipment, training, and pay in order to solve the corruption issues at hand. Also, stiffer penalties need to be levied, particularly for those involved in smuggling and terror financing. As it stands, many corrupt officials spend very little time in jail; often back out on the job within a few days.

Paraguay now has laws against money laundering and terror financing which it did not have in 2001, yet the Judiciary is particularly weak in Paraguay, making the enforcement of these laws nearly impossible. Additionally, preventing the “pay-off” mentality where violators of the law can simply pay the judge or arresting officer an amount under the table may need an entire generation of Paraguayans accustomed to real law enforcement to subside and the legitimacy of any new laws to take hold. The TBA is

¹⁸² Friman and Andreas, *The Illicit Global Economy and State Power*, 13.

¹⁸³ *Ibid.*, 66.

in desperate need of more robust customs procedures. As a CBP report in 2010 pointed out, there are no closed circuit television cameras monitoring the border, no uniformed agents stopping vehicles, the passport controls are not linked to INTERPOL's database, there are no canine units in place, and there is not a consistent system in place for stopping trucks and containers passing through the checkpoints. Paraguay is in the need of tremendous infrastructure, yet the country does have natural resources and although there is poverty, people are not necessarily starving in the streets. In order for Paraguay to succeed it will need to raise its government's revenues through better tax legislation. In Colon, for instance, the government has progressively stepped up its efforts to collect at least small amounts of revenue from VAT and export measures. Paraguay should attempt to do the same.

A method to collect revenue and improve infrastructure, which has been a sour note for Paraguayan politicians for a while, is to renegotiate the Itaipu and Yancreta Dam contracts with Brazil and Argentina. As it stands, Paraguay is forced to sell their most valuable commodity (hydroelectric power) at an unreasonably low price to its larger neighbors, thus preventing the government from reinvesting these revenues on things like security for its people. The Paraguayan state is still incapable of handling some of these issues, which will require a decided push by regional and international actors to remedy the current situation.

Finally, for Paraguay to deal with the TBA it needs to have the political will for change to occur. There appears to be some movement in a positive direction. Under President Lugo SENAD has been given more flexibility and greater autonomy to pursue law enforcement in the TBA. In 2009, SENAD signed cooperation agreements with local and foreign institutions including the municipality of Ciudad del Este, the Brazilian Federal Police, and the Education Ministry. This political will should enable collaboration and intelligence sharing with foreign institutions as well as provide training on drug prevention to the youth in Ciudad del Este and various government institutions.

2. Regional

The governments of Brazil, Argentina and Paraguay need to establish greater efforts to monopolize the use of force in the territory and take it away from criminal elements. As criminal organizations “realize the extent of their influence and power in the face of weak government or half-hearted efforts to control them, it is not too fantastic a leap to see these groups going beyond efforts merely to neutralize government enforcement but to become the government.”¹⁸⁴ Cooperative measures between Brazil and Paraguay are in fact more likely now as Brazil, which is trying to clean up its image for the upcoming FIFA World Cup and Olympics, is motivated to keep a clean image with the international community. Even so, at times, the Brazilian and Argentine governments refuse to acknowledge the existence of terrorist cells in the TBA altogether. President Lugo of Paraguay calls terror financing in the TBA “a myth” and in “December 2009, withdrew the counterterrorism legislation that would modify some aspects of the criminal code over objections raised by human rights organizations who argued that the new legislation threatened the international protection of human rights and may undermine freedom of assembly and freedom of speech.”¹⁸⁵

There are now even political movements in Argentina and Brazil that want to deny foreign aid to the area for fear that the United States and others are conspiring to establish a military presence along the Parana Aquifer, a known cash crop for the future of the world’s water supply. Yet another example of protectionism from international scrutiny concerns a new Hollywood feature film titled, “Triple Frontier,” set to begin filming in 2011. A joint meeting of the tourism ministers of all three TBA nations met in 2010 in Ciudad del Este to halt filming the movie in the TBA for concern that the film could bring unwarranted attention to the area.¹⁸⁶ According to Paraguay’s National Anti-drug Secretary, “today we have huge difficulties in cooperation between authorities on

¹⁸⁴ Phil Williams and Ernesto Savona, *The United Nations and Transnational Organized Crime*, (New York: Frank Cass & Co, 1996), 199.

¹⁸⁵ Beittel, *Paraguay: Political and Economic Conditions and U.S. Relation*, 13.

¹⁸⁶ “Brazil and Neighbors at Triple Frontier mad at Oscar-Winning Bigelow latest movie,” Brazzilmag.com, accessed May 11, 2010, <http://www.brazzilmag.com/component/content/article/86-may-2010/12182-brazil-and-neighbors-at-triple-frontier-mad-at-oscar-winning-bigelow-latest-movie.html>.

the Paraguayan side and getting information from the Brazilian side, and vice-versa.”¹⁸⁷ With Paraguay’s infrastructure issues and Brazil and Argentina’s benevolent attitude towards the larger global issue, the best recourse moving forward is to stress regional cooperation.

Paraguay, Brazil and Argentina are all members of the OAS and as such subscribe to the Inter-American Convention against Corruption and the Inter-American Convention against Terrorism. As signatories of these conventions, pressure to conform the TBA to eliminate the pervasive issues should go through the OAS. The GOP also signed the OAS Inter-American Drug Abuse Control Commission (CICAD) Hemispheric Drug Strategy, which should make corroboration on drug problems easier between the affected states in the TBA. Paraguay also has law enforcement agreements with Brazil, Argentina, Chile, Venezuela and Colombia.¹⁸⁸ Therefore, there are institutional and legal frameworks in place for cooperation.

The preeminent way to enforce the rule of law in the TBA is to stress regional law enforcement. The TBA represents a unique area where national sovereignty issues must be put aside and cross-border police action must be allowed. The countries of Brazil, Paraguay and Argentina pride themselves on the unity afforded by MERCOSUR, yet the TBA SEZ goes unregulated and relatively un-policed. A regional police force should be created along the lines of a EUROPOL and ASEANPOL, other common market police forces that have achieved some measures of success in the area of regional cooperation. In 2009, the 37th meeting of MERCOSUR in Asuncion, Paraguay, for instance, utilized contracted police forces from INTERPOL¹⁸⁹ for security purposes. Not only does this spell Paraguay’s infrastructure problems but it is also a telling sign that a sovereign trading block like MERCOSUR must seek help outside help to maintain law and order. If MERCOSUR wants to legitimize itself they must be able to police their own backyard,

¹⁸⁷ Ultima Hora, “Paraguay es la oficial oficina del PCC y Comando Vermelho,” 48.

¹⁸⁸ U.S. Department of State, *International Narcotics Strategy Report Volume 1*, 498.

¹⁸⁹ “Lugo calls Congress to vote for Venezuela’s Mercosur incorporation (June 28th 2010),” accessed July 17, 2010, <http://en.mercopress.com>.

or at least secure their own meetings. A newly created MERCOSURPOL could accomplish police tasks more efficiently and be used to police other problematic SEZs within MERCOSUR's jurisdiction.

Cooperation needs to extend to the judicial side of the equation as well. Paraguay's severe infrastructure problems and a lack of public prosecutors is not a problem with a likely short-term solution. In 2004, MERCOSUR established the Administrative Labor Court to deal with labor disputes between unions and employers and the Permanent Review Court to settle disputes between member nations¹⁹⁰, however, they failed to establish a court to handle the wide variety of criminal activities happening within in their own SEZs. MERCOSUR needs to establish a means to try fraud, corruption, money laundering, and smuggling cases. The extradition of criminals to the ICJ is capable of handling "big fish" like Ahmad Barakat, but MERCOSUR needs a judicial system capable of handling some of the "smaller fish" engaged in terror financing. MERCOSUR did establish the Center of the Promotion of Rule of Law, an organization that promotes academic research, organizes conferences, seminars, and forums to analyze and strengthen democratic governability. Although in theory the creation of this organization shows promise, in practice it merely amounts to an institution with little legitimacy and a severe lack of state funding. More must be done on the regional level to prosecute criminals.

Finally, if organized crime and terror financing thrives where lucrative profits are made by illicit means, an economic solution to the problem must exist. Criminal organizations tend to have a home base in areas where risks are low and engage in providing illicit goods and services to markets where the profits are very high. The TBA's unique characteristics as a FTZ allow this to happen. Although these benefits have attracted legitimate businesses and boosted the Paraguayan economy, the lack of institutional oversight by MERCOSUR to monitor containers entering Ciudad del Este, border security methods to track raw materials at the point of entry, and a consolidated system to administer the Brazilian VAT, all contributes to the vulnerability of the TBA as

¹⁹⁰ Mario Viola de Azevedo Cunha, *The Judicial System of Mercosur: Is there Administrative Justice?*. Institute for International Law and Justice, New York University School of Law, 2006.

a viable SEZ. Additionally, smuggling operations like the drug trade have become more agile and less traceable, stimulated by economic reforms such as privatizations and financial liberalization, which expanded the flexibility of traffickers to reinvest their money.¹⁹¹ The SEZ in the TBA multiplies the flexibility of smugglers by providing a marketplace to move goods easily and reintroduce their dirty earnings into the formal economy. Paraguayan businesses already enjoy a comparative advantage with respects to labor costs and lower manufacturing overhead due to cheaper electricity. Also, local law grants Paraguayan companies a 15% price advantage over foreign competitors. The SEZ is an added incentive that provides a small marginal advantage, especially considering that most of the smuggling activities involve materials and goods that are not manufactured in Paraguay at all. The cleanest solution to the problem is to eliminate the SEZ altogether, as organized crime is profiting from it more than legitimate business. However, the political economy of the region, particularly in Paraguay, makes this a doubtful solution.

By making the risk-reward ratio higher, organized crime should at the very least slow down. The TBA is one of the least regulated economic zones out of the 3,000 FTZ's worldwide.¹⁹² The risks are relatively low in the TBA because the rule of law remains weak and the chances for illicit activities being discovered are fairly low. By improving the rule of law through legislation and cooperation the risks become larger, but by reducing the profits margins of illicit activities organized crime should begin to collapse. Profits in the TBA are largely founded on cash transactions. The retail cash market in the TBA is ranked third worldwide only after Miami and Hong Kong.¹⁹³ The use of cash in the TBA continues to be important because it is easy to use in trade transactions. Cash does not require financial institutions and presents particular money laundering and terror financing incentives because of its portability, anonymity and lack

¹⁹¹ Luiz De Andrade Filho, "The Dynamics of Drug-Related Organized Crime and Corruption from a Development Perspective," *Journal of Financial Crime* 15, no. 1 (2008): 49, accessed September 12, 2010, <http://libproxy.nps.edu/login?url=http://proquest.umi.com/pqdweb?did=1440894831&Fmt=7&clientId=11969&ROT=309&VName=PQD..>,

¹⁹² "Money Laundering vulnerabilities of Free Trade Zones," *FATF Report*, March 2010, 34.

¹⁹³ Hudson, *Terrorist and Organized Crime Groups in the Tri-Border Area (TBA) of South America*.

of an audit trail. Improved oversight of the duty free zones would hamper illegitimate businesses like the small casinos in Argentina, the thousands of pirated software stores in Paraguay, and informal currency exchange shops in Foz do Iguacu that deal strictly in cash.

Another pervasive issue in the TBA is that customs document management and administration varies in the TBA depending on which border you cross and in which direction you cross it. Theoretically Zone transactions must be reported to Zone authorities and Customs authorities, however Zone authorities and Customs authorities operate under two different, un-integrated systems in the TBA. This lack of centralized control is magnified when customs officials from different countries are involved in tracking the shipment of goods. Cigarettes, alcohol, and other high duty items are more vulnerable to smuggling due to the increased revenue that can be generated by not paying tax. The high volume of containers, the ease of repackaging and relabeling shipments within the zones, and the lack of oversight make the TBA rife for exploitation of smugglers attempting to avoid high duty and tax rates particularly on cigarettes and alcohol. These lost tax revenues could, for example, go to the Paraguayan state to improve infrastructure. Additionally, the lack of institutional oversight by MERCOSUR to monitor containers entering the SEZ, border security methods to track raw materials at the point of entry, and a consolidated system to administer taxes, all contribute to the vulnerability of the TBA. By improving customs procedures cigarettes and alcohol entering the TBA would incur a tax that would then be delineated with a tax sticker on cigarette boxes, facilitating accountability for export into Brazil and Argentina. By the same token, an environment with more inspections and less cargo coming in and out, would make it relatively harder to take advantage of relaxed oversight in order to import, repackage, re-label and export textiles or IT equipment destined for Brazil or a third country like Argentina or Uruguay.

Repackaging in SEZs is one of the tools used by criminals to cut the links with the real country of origin or destination, thus avoiding taxes and oversight. Improved oversight would decrease the incentive to repackage materials because every container coming in would have to be inspected and taxed based on the country of origin.

Organized crime like the Chinese Mafia that imports cheap electronics and pirated movies would not be able to easily smuggle these products into Brazil through the TBA. Additionally, groups like the FARC and Brazilian Mafia would not be able to hide illicit drug shipments within containers of goods headed for export out of the TBA as easily.

Organized crime in the Triple State Border Area between Paraguay, Brazil and Argentina represents a serious security issue that must be solved by improving the rule of law and focusing on transnational cooperation. Although the elimination of the FTZ is the cleanest method for combating transnational organized crime in the TBA, improving the rule of law and focusing on cooperation is no doubt more realistic for the security of the region. Creating an environment where the risk-reward ratio increases will hamper organized crime from making the lucrative profits it enjoys today. The economic incentives for legitimate businesses would certainly decrease, but it would severely raise the cost of doing business for organized crime syndicates who profit most from the TBA's FTZ.

3. U.S. Recommendations

Given the location of Paraguay and the amount of narcotics and smuggled goods that go into Brazil's economy which is not directed to the United States, it is tempting to say the problems in the TBA are only a regional problem that should be left in the hands of Paraguay and its neighbors who suffer the consequences. After all, if Paraguay becomes what Mexico is to the United States, then it should be up to Brazil, its largest consumer to handle the security issues. A small portion of the cocaine that transits Paraguay is actually destined for the United States with the bulk ending up in Brazil, Europe, Africa, and the Middle East. However, money laundering and terror financing are sizeable problems in the TBA that have consequences for the United States in its fight against transnational terror organizations. Moreover, if organized crime continues to manipulate and override the democratic institutions that Paraguay has in place, it is not too far-fetched to see Paraguay slide into a narco-state like Afghanistan, which in the

context of the Paraguay's location in the Western Hemisphere would most likely require more resources from the United States that are already stretched thin by the wars in Iraq and Afghanistan.

The United States should continue to use interagency efforts to affect the business practices in the TBA with a decisive focus on fighting corruption and improving the rule of law. The U.S. Mission in Paraguay collaborates and helps guide the GOP in its efforts to combat drug trafficking organizations, build legal and regulatory measures, restrict illegal contraband flows, and trace money laundering. In 2009, the narcotics detection canine program instituted by U.S. vetted units was responsible for the direct seizure of 65 kilograms of cocaine.¹⁹⁴ Funds from the U.S. Mission in Paraguay filter to units of SENAD, the Secretariat to Combat Money Laundering (SEPRELAD), and the Specialized Anti-Piracy Unit (UTE) agents. These funds are also used, and should continue to be used, to sponsor seminars on information sharing, trademark fraud, and money laundering. Targeted aid to Paraguay should consist of continued ICE vetted TTU units to help improve the financial system in Paraguay and make it come up to FATF standards in its practices against money laundering and terror financing.

Improving GOP infrastructure should also be a key focus for the U.S. Mission in Paraguay. There are currently projects underway to improve SENAD's physical headquarters in Asuncion. Similar projects should translate to the TBA where major infrastructure needs are necessary. The CBP has identified several deficiencies in the TBA with respect to the physical security of the SEZ. The SEZ in Ciudad del Este is not closely guarded, there lacks uniformed security personnel to inspect containers and cargo coming in and going out of the zone, there are no closed circuit TVs in place to guard the border, and the overall customs regulatory practices are antiquated. For example, better technology to track shipments, annotate point of registry, and for safeguarding the perimeter of the SEZ is needed.

¹⁹⁴ United States Department of State Bureau for International Narcotics Control and Law Enforcement Affairs, *International Narcotics Control Strategy Report, Volume 1 Drug and Chemical Control*, 499.

Tackling corruption in Paraguay is probably the biggest single issue in solving the problem in the TBA. The dark networks involved in Ciudad del Este are not easily disrupted without the legitimacy of the GOP. The U.S. Agency for International Development (USAID) began the second phase of the Millennium Challenge Corporation anticorruption project in 2009 that targets corruption within the judicial system and Paraguayan National Police. This is a herculean effort that USAID cannot tackle on its own. There are insufficient funds to really make a dent in tackling the issue, especially as drug traffickers and organized crime begin to erode state legitimacy. The best possible solution would be to continue to pump up the legal and regulatory framework as the United States did in Panama by putting pressure on not only Paraguay, but also Brazil and Argentina to change the way business is done in this very problematic SEZ.

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V. SUMMARY ANALYSIS AND CONCLUSIONS

A. CASE COMPARISONS

The two cases examined in this paper illustrate that many key security issues surrounding SEZ's in Latin America are in fact similar. Smuggling, intellectual property violations, money laundering and terror financing are the most rampant and pressing issues in both cases, although to a varying degree. This final chapter will shed light on the questions brought forth in Chapter I by comparing and contrasting the two cases and will finish by bringing forward policy recommendations with a step down approach from international regimes down to U.S policy.

Similarities in both cases are hard to miss. Colon and the TBA are both located in along major drug trafficking routes. Also located within the SEZ's, or in close proximity, are entrenched mafia groups and organized criminal organizations tied to the drug trade. Additionally, there are also individuals and organizations that use the permissive environment to launder money or to raise funds for terrorist activities. The governments of both Panama and Paraguay established these SEZs as national development tools. In Panama it was a case of neo-liberal economics whereas in Paraguay it was arguably motivated more by structuralism. Either way, development economics were heavily involved in the decision making process during the SEZ establishment phase. Political and economic actors in both cases struggle with finding the balance between security and globalization, but tend to lean towards lean regulations. Both SEZ's also have political economies where entrenched corruption and a history of co-opted public officials have eroded state legitimacy to some degree. In fact, both Paraguay and Panama became democratic at the same time with the deposition of their respective military dictators in 1989.

Although there are plenty of the similarities between Colon and the TBA, the manner in which these two SEZ's operate could not be more different. Colon has a substantial security apparatus, made further secure by recent legislation. On the other hand, the TBA's security apparatus is practically non-existent. Colon is an

internationally recognized SEZ where large multinational firms want to locate and conduct business. The TBA lacks any large multinational firms and operates more as a loose conglomerate of small independent import-export companies and duty free shopping malls with independent vendors. In Colon, the use of credit loaned from Panama's dynamic and vibrant financial sector is readily available. In the TBA cash is king. In fact, not just cash, currencies other than the local Paraguayan denomination are the preferred monetary instruments. The differences highlighted above provide a stark contrast and show how SEZ's, which are supposedly 'extraterritorial' entities in a similar region, can yield such varied results.

There are plenty of explanations that can attempt to explain the different outcomes from the case studies. Some could in fact simply argue that the CFZ has existed longer than the TBA, allowing it time to develop the infrastructure necessary to operate as a viable SEZ, whereas the TBA lacks the additional 20 to 30 years of development. Perhaps if one looked at Colon two decades ago, it might actually look more like Ciudad del Este does today. Another argument is the contention of their different geographic locations. The CFZ is located at a major trade route between the Atlantic and Pacific Oceans, where large multinational firms want to locate as a viable method to speed production and shipping times and get their products from Eastern to Western markets, and vice versa. That said, Paraguay's low tax rates and central location are also hard to beat. The TBA is at a natural crossroads and strategic point on an international border with Brazil and Argentina, a fantastic place for assembly and distribution facilities for the 200 million consumers in the MERCOSUR market. Yet, arguments can be made that those markets are not quite as lucrative as the ones the CFZ serves. Additionally, there are other avenues to penetrate Argentina and Brazil's markets than necessarily through the TBA.

The differences extend innately to their operations. Although both SEZ's lack backward linkages and technology transfer to fully industrialize (as described in Chapter II), the CFZ has decidedly grown robust ties to its financial sector and service sector that the TBA has not. In the CFZ banks loan credit to companies who in turn use it to conduct business or invest further in the SEZ, also creating spillover effects in Colon. For

instance, FDI in the CFZ contributed to the establishment of regulated duty-free shopping malls, increased tourism, and the development of some low skill industrialization in and around Colon. Panama did not choose 'export processing', deciding instead to rely on the business of re-exports and leveraging a large service sector to support it. In the TBA, however, there are no signs of any backwards linkages to the economy (financial, tourism, or other). Sure there are duty free shopping malls, but most are not captured by the formal economy because they are not regulated at all. Tourism has not exactly taken off in Ciudad del Este either. Most visitors come to Ciudad del Este for a day of shopping but head back to Brazil or Argentina to stay the night. Some may even drive all the way back to Sao Paolo, choosing not to stay in the TBA at all.

To be sure, the disparities in the two cases also surround the amount of regional and international scrutiny placed on them. For instance, decisive U.S. pressure has forced the CFZ to conform to the regulatory framework of one of its largest trading partners; the United States. Even after the United States pulled out of Panama, the CFZ's proximity to the United States, the fact that there are U.S. corporations heavily invested in the area, and its position at the entrance to the Panama Canal have brought heavy U.S. attention to Colon. Until just recently, the TBA's remote location has not produced nearly as much international scrutiny. In fact, most U.S. diplomats probably could not point to where the TBA was on a map until after the terrorist attacks on the World Trade Center. Likewise, even though a security breach through the TBA in the 1990s resulted in the terrorist bombings in Buenos Aires, Argentina did not have the resources or abilities to deal with the threat on its own. Moreover, Brazil's emergence as the regional hegemon in South America is fairly recent. Before Brazil's deep well oil reserves were found in 2005, regional hegemon was more or less a toss-up between Brazil, Argentina or Chile.

Therefore, juxtaposing the two cases in this study readily shows that the security dimension is highly affected by internal and external variables. Although there are certainly illicit actors engaged in Colon, they do not dominate day-to-day operations like the ones invested in the TBA. In Colon the security piece is there, even if the ability for it to function properly comes in question at times. In the TBA, the security piece seems like it is all together missing, and whatever is currently there is acutely inadequate. The

key differences in the security sectors of the CFZ and the TBA are the legal frameworks established, the training and equipment of security actors, and the external pressure (or lack thereof) to conform to international standards.

Put simply, the legal framework in the CFZ is better than in the TBA. Both cases have judiciary problems, but Panama's laws and regulations to govern its SEZs are more credible and have existed longer. The CFZ, for instance, was created by a written law decree, where the TBA was established based on the verbal authority of a dictator. Panama has laws for each of its numerous SEZs, even the newest ones like the Special Panama-Pacific Economic Area (formerly Howard Air Force Base), which was created by means of Law No. 41 on July 20th, 2004, establishing an autonomous entity of the State and given specific regulations and authority to address development. In fact, the creation of Panama's newest SEZ was done in the exact same manner as the CFZ was in 1948. On the other hand, when the TBA was declared a Zona Franca (Free Zone) in 1965 by President Stroessner, it was not established based on any written laws. As a matter of fact, not until 1995 when domestic law 523 was enacted, did Paraguay actually establish a Free Zone Regime to manage SEZs. Legal framework came much too late in Paraguay. Ciudad del Este's Free Zone status was allowed to grow on its own for nearly 30 years without laws to govern its operations.

The cases also show that although the bureaucracies of both nations are extremely large and corrupt, Panama is more transparent. Although Panama's judiciary is often questioned, the fact of the matter is that it is more robust, with more public prosecutors to go after criminals, and much less corrupt than Paraguay's. There is a vast difference (and a lot of countries) between Transparency International's ranking of Panama 73rd and Paraguay's 146th out of 178 countries on the 2010 International Corruption Perception Index. Simply stated, the levels of corruption in Paraguay are debilitating. There are many explanations for this, but what the case study clearly points out is that Paraguay is historically defined as a country of "strong men" where power is traditionally concentrated in powerful families. It is a nation where the control mechanisms of a legitimate state, its laws, have conspicuously been absent. This lack of transparency and control, coupled with the arbitrary use of power has contributed to the development of

institutionalized corruption. During the Stroessner years, “El Stronato” (1954–1989), 40 years of corruption was in a sense feudalized, where “strong men” in the government parsed out “fiefdoms” of legal and illegal businesses among military and civilian governors. This tradition of “feudalized corruption”¹⁹⁵ coupled with the lack of transparency in public administration remains visible today and contributes to the weak legal framework in the TBA.

Adherence to international regimes also plays a role in the legal framework differences. Panama can boast to adhere to more international regimes governing financial crimes, drug trafficking, weapons smuggling, trade, and terrorism than does Paraguay. International regimes in turn foster the development of national laws; again, going back to the normative behavior of states. In Panama, it worked with decided U.S. pressure, but Paraguay is notoriously a late adopter of international regimes and norms. In fact, it was not until 2010 that Paraguay established a law against terrorist financing. This allowed many in the TBA to escape persecution.

Secondly, the training and equipping of security actors is insufficient in the TBA as compared to the CFZ. Part of this is due to President Martinelli’s recent professionalization of the Panama’s security sector. In the recent past, Panama’s security actors were not as well trained, equipped, or paid as they are today. Yet it would be remiss to say that the CFZ’s security was ever as bad the TBA today, even after these reforms. In Paraguay, there are some severe vulnerabilities. For instance, customs inspections do not necessarily occur, and when they do, only the most minimal checks are done due to insufficient staffing and training. The methods used in the TBA lack any risk assessment or targeting system like the Container Security Initiatives or the Mega ports radiation detectors found in Panama’s CFZ. Port operations are conducted to minimal standards. The CBP report of the TBA in 2010 highlighted that “some basic inspectional tools such as screwdrivers, drills, flashlights, and forklifts are nonexistent in the TBA.”¹⁹⁶ Additionally, more sophisticated equipment like fiber optic scopes, density meters, x-ray machines, and gamma machines are simply not available for use in the

¹⁹⁵ Dreyfus, “Investicacion del Proyecto Control de Armas de Fuego, Viva Rio/ISER,” 4.

¹⁹⁶ Office of International Affairs, “Paraguay Tri Border Assessment,” 16.

TBA where they are at least on hand in the CFZ. There are no document analyses, container inspection techniques, shared databases or electronic means to secure the data if it were obtained. As a comparison, The Colon Free Zone is criticized for not becoming fully compliant with electronic invoicing methods, but in the TBA, finding an invoice at all would be a step in the right direction.

Finally, the role of the United States in Panama cannot be overstated in the development of a viable security sector. As one of Panama's largest trading partners and investors, the United States has played a key role in shaping the way the CFZ operates, if not directly then by diplomatic pressure. As the United States seeks to sign a Free Trade Agreement with Panama it has diplomatically tightened the screws on regulatory practices. To make the CFZ more transparent, the United States pressured Panama to sign Mutual Legal Assistance Treaties, Tax Information Exchange Treaties, Double Taxation Treaties, and abide by FATF regulations. Additionally, placing pressure on the GOP to conform to the OECD's TIP regulations, as well as numerous other conventions, has made Panama a more transparent place to do business and a partner in fighting organized crime and transnational terror organizations. The United States has not simply put forth lip service, it has also backed up the talk with yearly bilateral military exercises, efforts from multi-agency task forces, and by putting money and equipment in the hands U.S. vetted units of the Panamanian security forces. The same cannot be said in the TBA. Although the United States has made efforts in all of the categories mentioned above, the resources have not been quite as robust.

Truthfully, the direct security threat to the United States is not as high in Paraguay as it is in Panama. Undoubtedly the issue of drug and weapons smuggling is really hampering Brazil's security and affecting the United States only marginally, particularly as many of these illicit goods find their way into the favelas (slums) of Rio de Janeiro and Sao Paolo. The question becomes, why has Brazil not done more to secure its borders or help Paraguay solve some of its infrastructure problems in the TBA? The case study of the TBA reveals some of the internal politics between the two nations and brings issues of Paraguay's national sovereignty and also to some extent the perceived economic necessity of the current situation. However, there are indeed mechanisms in place to

enhance cooperation between Paraguay and its “big brother,” not the least of which is their shared regional trading block the MERCOSUR.

Actually, MERCOSUR has made some impacts in the TBA. For instance, the 1995 Paraguayan law establishing national SEZ regimes was influenced by MERCOSUR suspiciously leaving Paraguay out of their Decision n° 8/94 where the exportation tariffs of the Brazilian Free Zone of Manaus and the Argentine Zone of Tierra del Fuego were set. Paraguay was intentionally left out of the decision because it lacked enough institutional controls over the SEZ in Ciudad del Este. Thus, Paraguay could not be equated with Mercosur partner countries, especially Argentina and Brazil, which by then had laws on special economic zones already in place. Paraguay quickly jumped through the hoop provided by MERCOSUR and established a national law governing SEZs the very next year. This is an example where external pressure conformed Paraguay to a MERCOSUR standard, and thus an international standard (at least legally). Despite this instance, these types of pressures from the TBA’s largest trading partners (Brazil and Argentina) have been largely deficient throughout its development as an SEZ.

Brazil has pledged cooperation, it has delivered a handful of aircraft (without training) to the Paraguayan Air Force, and it has stepped up some measures on its side of the border like flying UAVs, but the dedication to solve the true infrastructure and rule of law problems in the TBA are not there. Although Brazil is spending vast amounts of resources to clean up its act for the coming 2014 FIFA World Cup and the 2016 Olympics, where the eyes of the international community will be on Rio de Janeiro, they should not be let off the hook for the issues in Foz do Iguacu and the TBA. Brazil needs to treat the TBA in much the same manner the United States treated the CFZ: put decided regulatory pressure, act as the regional hegemon, and then back it up with real resources.

There is no easy answer to the problems found in Latin American SEZ’s. Hopefully, the case studies of the CFZ and the TBA show that there are some valuable lessons learned in Panama that can translate to the TBA, and perhaps other more problematic SEZs. Improving regulatory practices, equipping and training security actors, and leveraging external political pressures can guide the most deficient SEZs to become more secure.

B. MOVING FORWARD: STEP-DOWN POLICY APPROACH

Specific policy recommendations have been discussed for the two case studies examined in this paper. Although recommending an economic policy for an SEZ, city, country, or region can be difficult, setting policy on the issue of SEZ's on an international scale is even more daunting. With any changes there must be cross cooperation and open dialogue between all parties and a common language must be used. This becomes increasingly difficult when working with delegates of different governments. However, these issues must be overcome if there is to be a concerted international effort to disrupt smuggling, organized crime and the flow of resources that fund terrorism in Latin American SEZs. For the next section of this paper, policy recommendations for organizations, ranging from the international, regional, and U.S. unilateral level will apply. By using a three-tiered strategic approach, the pervasive issues common to all SEZs of can be throttled back.

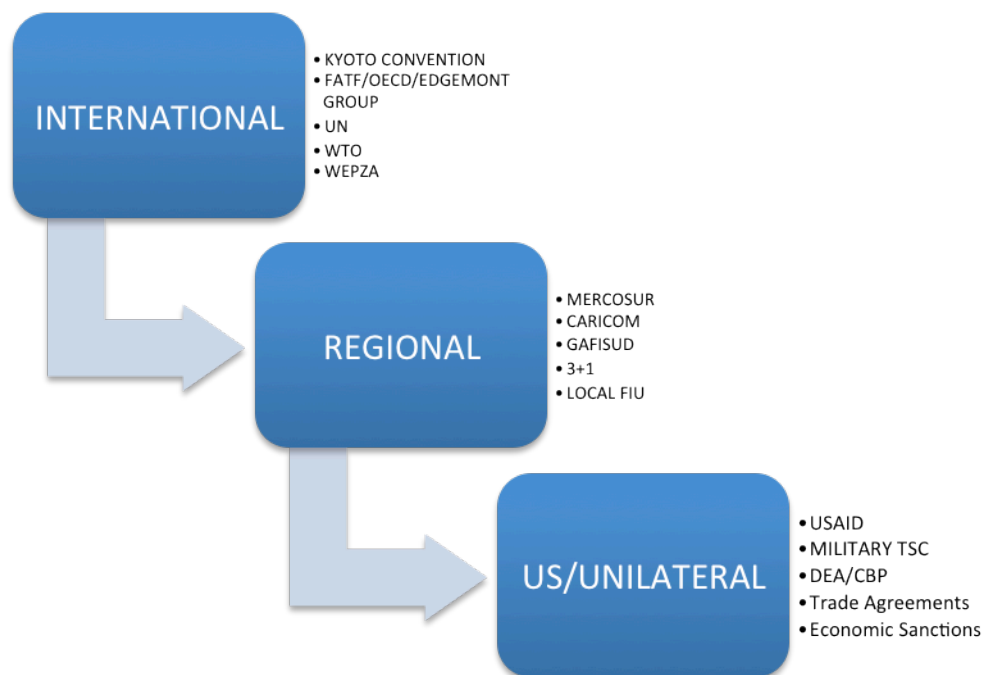


Figure 15. Step-Down Policy Approach

1. International and Regional Recommendations

The problems found in the SEZs of Latin America extend to SEZs outside the region to places such as the Philippines, India, Dubai and others. As we saw in Chapter II, SEZ's have proliferated throughout the world. Thus, especially in the context of globalization and a shared language, there needs to be an emphasis on cooperation coming down from the international and regional levels. Only in this respect can U.S. policy work in the region.

The Revised Kyoto Convention treats free zones as an area with some “extraterritorial” elements, while WTO law does not accord such treatment to free zones. The WTO regulates them according to the norms of free trade and minimal national subsidization laws. Thus, the regulatory framework under the WTO is far less flexible and more stringent than under the Kyoto Convention and should be the standards to which SEZs in Latin America adhere. As of June 1, 2010, 63 out of the 69 contracting parties to the Revised Kyoto Convention are members of the WTO, so they must live up to their commitments under both legal systems.

In regard to the case studies examined, neither Paraguay or Panama are contracting parties to the Kyoto Convention, however they are both members of the WTO. As the premier international ruling body on trade, the WTO needs to take an active role in governing SEZs. Issues like trade-based money laundering and corruption can be addressed through WTO norms and regulations. U.S. policy directed at SEZ's needs to filter through the WTO when addressing some of these issues in particular. Other International bodies that pertain to SEZs include the ILO, WCO, and OECD, but they regulate specific areas like trafficking in persons and labor standards, not necessarily some of the more pervasive issues found in this report. That said, these organizations should also seek an active role in standardizing SEZ operations.

Regional trade bodies should also be stressed and involved in solving some of trade related crimes. As demonstrated in this paper, MERCOSUR can play a tremendous role in policing SEZs that fall within its jurisdiction by placing trade restrictions on those SEZs that are not compliant or by leaving insubordinate SEZs out of trade negotiations.

Other regional trading blocks in Latin America, like the Andean Community of Nations (CAN) and the Caribbean Common Market (CARICOM), should feel the pressure to conform their SEZs to a standard.

The United Nations is another governing body with a considerable amount of international prestige and resources to combat nearly all of the illicit activities found in SEZs, like weapons smuggling, narcotics smuggling, terror financing and money laundering. Since all Latin American nations are also subject to membership guidelines in the UN, the specific resolutions of UN 1267 and UN 1373 delineate how to deal with terrorist organizations and organizations that finance terrorism. As this paper exposed, money laundering is also a key security detractor that the U.N. has the unique ability to deter. The United Nations relies on the FATF for future policy recommendations with regard to money laundering and terror financing. The FATF published their recommendations on the vulnerabilities of SEZs and one of their goals is to continue to assess SEZs in their efforts to comply with the FATF 40 recommendations on money laundering and the nine special recommendations on terrorist financing published in 2001. The FATF reported in 2009 that the TBA had taken some steps to bring their financial system in line with international standards, but identified areas that required significant steps to be taken before they are in full compliance. They noted that “Under the leadership of a new Director of the Paraguay’s financial intelligence unit (Unidad de Análisis Financiero – UAF) appointed in August 2007, there has been notable progress in the quality and coverage of AML regulations. However, they also pointed out that Paraguay still falls short of complying with most of the FATF recommendations and, where legal provisions exist, implementation is generally not effective. Furthermore, the level of awareness of money laundering and financing of terrorism (ML/FT) risks is low in both the public and private sectors.”¹⁹⁷

Both Panama and Paraguay, although not direct members of the FATF’s international regime, are members of the FATF’s regional body named the GAFISUD. They are also members of the Edgemont Group, a conglomerate of FIUs that share

¹⁹⁷ Financial Action Task Force, *Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism-Paraguay*, December 2008, 5.

information in order to combat money laundering. It should be noted, however, that many other Latin American countries (like Guatemala and Venezuela) are not members of either institution. A concerted effort must be applied to all Latin American nations to join the FATF and the Edgemont Group and adhere to their guidelines. The FATF also publishes recommendations on dealing with corruption. The United States should emphasize participation with FATF as a major pillar in conducting diplomacy and also establishing trade agreements in Latin America.

The UN is also involved in fighting drug related crimes. The United Nations Office on Drugs and Crime recently opened an office in Panama in the port of Balboa to begin a comprehensive regional program to inspect containers. The program will be based in Panama, “from where it will provide technical assistance and training for customs control agents in Central America, Mexico, and the Caribbean. The UNODC donated to the Customs Authority a laser monitor worth 80,000 dollars that can detect drugs, explosives, and money.”¹⁹⁸ Again, effective policy must go through international and regional organizations.

WEPZA (World Export Processing Zone Association) is yet another international body that holds credibility on the way SEZs operate. It is perhaps the only specialized agency that deals strictly in SEZ policies. It was created as an arm of the UN in the 1970s, but has since been privatized. It is now a loose association of former Zone Managers and economists that hold workshops and conduct seminars on all kinds of different matters concerning SEZs. Although it is not a regulatory body, perhaps more emphasis should be placed on institutions like WEPZA to offer credible, informed, and specialized guidance. WEPZA, given proper authority, could be transformed into an international regulatory body for SEZs, perhaps as an arm of the WTO. It could, for instance, establish standards by which SEZs are inspected to receive a rating. More emphasis needs to be placed on standardized practices in SEZs on a global scale.

¹⁹⁸ Eduardo Mendoza, “Panama Vulnerable to Drug Trafficking,” *La Prensa*, June 23, 2010.

Bottom-line, policy change will only be effective if there is proper institutional framework in place at the international and regional levels, allowing the flow of communication between organizations. This framework is expensive and difficult to piece together. At times, the types and numbers of individuals that are required to become effective at the domestic level are not easily produced and these individuals may not have the regional expertise to be necessarily effective. If the U.N., FATF and other bodies want to be relevant in shaping SEZ policy against key illicit activities they will need to be significantly involved with setting up and properly training and manning the organizations that will work within Latin America and inside host nations.

2. U.S. Recommendations

There are a multitude of international and regional institutions in place for the United States to collaborate on the issue of SEZs. This leaves many options for U.S. policy makers when deciding on a course of action to deal with illicit activities. The first tool at the United States' disposal is diplomacy. Effective diplomacy will allow the United States to engage Latin America openly and attempt constructive dialogue that will help foster change in regional and domestic SEZ policy, as evidenced in the Colon Free Zone. The United States must continue to work with the U.N. and the FATF to shape host countries financial systems that more closely mirror international guidelines to bring about changes within SEZ's. The United States should also look into using economic inducements when attempting to change Latin American SEZ policies. These inducements can be used to help setup the institutional frameworks that are currently lacking within their system or used as a "carrot" for the efforts to change their policies and bring them more in-line with the FATF's recommendations and other international regulatory framework.

As examined in Chapter II, free market diplomatic engagements have been at the core of U.S.-Latin American relations since the Cold War. A globalized Latin America with ties to the world economy benefits the United States and free market reforms should not be abandoned as a major policy instrument. Thus, the final tool for the United States in fighting illicit SEZ activity is economic sanctions and unilateral efforts like

implementing executive order 13224 to freeze assets tied to terror financing under U.S. jurisdiction. Sanctions should not be used carelessly and should be used a “last resort” when dealing with a sovereign nation or attempting to disrupt a terrorist network or organized crime syndicate operating within the borders of a foreign nation. Also, freezing bank assets needs to be done carefully within the regulatory frameworks of host nations. The United States is still a major trading partner in Latin America, which leverages its position if sanctions are ever deemed necessary or unilateral efforts need to be implemented, but these should be considered a last recourse.

Whichever option the United States chooses to engage in, the most important aspect of implementation is the open communication between all organizations involved, especially when it comes to regional security. Without proper communication any attempts to bring recommendations to fruition will be met with apprehension and confusion that will stall or undermine the hard work already completed.

Finally, the United States should continue to implement bilateral efforts to train and equip host nation security actors. U.S.-vetted teams trained by the DEA, CBP, FBI, working with local police forces will help bridge the technology and knowledge gap and improve local security efforts until local security actors can effectively operate on their own. Also, organizations like USAID should continue to pour resources and training into improving the rule of law and fighting corruption. Theatre Security Cooperation between U.S. Mission personnel embedded within the host country should carry on in order to foster working relationships that coordinate effective interagency responses.

3. Conclusion

The United States’ “backyard” is certainly getting smaller as the rest of the world begins to encroach on Latin America. A globalized Latin America with open and free markets is at the core of U.S. foreign policy, yet the United States should also tread carefully to ensure that the free markets it seeks to promote are free from the criminal activities that could destabilize regional security and proliferate illicit goods. SEZ’s are a complex political and economic animal. They should be treated with proper attention and within the framework of bi-lateral, regional, and international cooperation. The case

studies in this paper demonstrate that by using a framework where the delicate political economies of the host country are taken into consideration, a much more effective policy can be determined and executed. Translating the lessons from the CFZ and the TBA to a policy for other SEZs in the region can be accomplished effectively if a step-down policy is used. Effective U.S. foreign policy begins by working within the international frameworks and international institutions already in place to put pressure on regional and domestic bodies to act. Effective U.S. policy must also engage countries with targeted aid and training. By implementing a focused step-down approach, SEZs can conform to international standards and become more secure. Operating within the framework of a globalized Latin America is the United States' best recourse moving forward.

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